No. 91-7804-CFX
Status: GRANTED

Title: Sheldon B. Bufferd, Petitioner
v.
Commissioner of Internal Revenue

Docketed:
March 31, 1992

Court: United States Court of Appeals for the Second Circuit

Counsel for petitioner: Filler,Stuart Jay

Counsel for respondent: Solicitor General

Entry	Date	Note	Proceedings and Orders
1	Mar 31 1992	G	Petition for writ of certiorari and motion for leave to proceed in forma pauperis filed.
4	Apr 30 1992		Order extending time to file response to petition until May 30, 1992.
5	Jun 1 1992		Brief of respondent Commissioner of Internal Revenue in opposition filed.
6	Jun 4 1992		DISTRIBUTED. June 19, 1992
8	Jun 22 1992		Petition GRANTED.
			**********
9	Jul 2 1992	G	Motion of petitioner for appointment of counsel filed.
10	Jul 24 1992		Joint appendix filed.
11	Jul 24 1992		Record filed.
		*	Original proceedings U. S. Court of Appeals, Second Circuit and U. S. Tax Court.
13	Jul 31 1992		Order extending time to file brief of petitioner on the merits until August 21, 1992.
14	Aug 21 1992		Brief amici curiae of Charles T. Green, et al. filed.
15	Aug 21 1992		Brief amicus curiae of Arthur Boelter filed.
17	Aug 21 1992		Brief of petitioner Sheldon B. Bufferd filed.
18	Sep 23 1992		Brief of respondent Commissioner of Internal Revenue filed.
19	Oct 5 1992		Motion for appointment of counsel GRANTED and it is ordered that Stuart Jay Filler, Esquire, of Bridgeport, Connecticut, is appointed to serve as counsel for the petitioner in this case.
20	Oct 13 1992		SET FOR ARGUMENT MONDAY, NOVEMBER 30, 1992. (3RD CASE).
21	Oct 23 1992	X	Reply brief of petitioner filed.
22	Nov 30 1992		ARGUED.

91-7804

No._____

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1991

SHELDON B. BUFFERD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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March 30, 1992

QUESTION PRESENTED

Whether the statute of limitations with respect to items appearing on a Form 1120S income tax return of a subchapter S corporation is to be applied at the corporate level as was decided by the United States Court of Appeals for the Ninth Circuit in Kelley v. Commissioner, T.C. Memo 1986-405, rev'd 877 F.2d 756 (9th Cir. 1989)?

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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1991

SHELDON B. BUFFERD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioner Sheldon B. Bufferd respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered in the above-entitled proceeding on January 3, 1992.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit is reported at 952 F.2d 675 (2nd Cir. 1992) and is reprinted in the appendix hereto, p. 1a, infra.

The opinion of the United States Tax Court is reported at 61 T.C.M. (CCH) 2410 (1991), and is reprinted in the appendix hereto, p. 6a, infra.

The statutory Notice of Deficiency issued by the Commissioner of Internal Revenue for Petitioners' 1979 joint federal income tax return is reprinted in the appendix hereto, p. 12a, infra.

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[1] By reason of a settlement between Phyllis Bufferd and Respondent, she is no longer a party in interest in this case.

JURISDICTION

Petitioner brought an action in the United States Tax Court for the redetermination of the deficiency imposed by the Respondent. The Tax Court entered judgment in favor of the Respondent on May 14, 1991.

The Court of Appeals for the Second Circuit affirmed the Tax Court's decision on January 3, 1992. No petition for rehearing was sought.

The jurisdiction of this Court to review the judgment of the Second Circuit is invoked under 28 U.S.C. Section 1254(1).

STATUTES INVOLVED

Internal Revenue Code of 1954[2]

SEC. 6012. PERSONS REQUIRED TO MAKE RETURNS OF INCOME.

(a) GENERAL RULE. -- Returns with respect to income taxes under subtitle A shall be made by the following:

* * * * *

(2) Every corporation subject to taxation under subtitle A;

* * * * *

SEC. 6037 RETURN OF S CORPORATION.

(a) In general. -- Every S corporation shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, the names and addresses of all persons owning stock in the corporation at any

[2]Because the taxable year in question was prior to the enactment of the Internal Revenue Code of 1986, all non-jurisdictional references are to the Internal Revenue Code of 1954 (Code).

time during the taxable year, the number of shares of stock owned by each shareholder at all times during the taxable year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, each shareholder's pro rata share of each item of the corporation for the taxable year, and such other information, for the purpose of carrying out the provisions of subchapter S of chapter 1, as the Secretary may by forms and regulations prescribe. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.

* * * * *

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) General rule. -- Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

STATEMENT OF THE CASE

All the facts of this case were stipulated by the parties and are contained in Documents 23 and 24 of the record. The Petitioner was a shareholder of a S corporation for his taxable year 1979 and claimed losses and investment tax credits incurred at the S

corporation level on his timely filed 1979 joint federal income tax return. The Respondent obtained an extension of the statute of limitations for the Petitioner's joint federal income tax return, but did not obtain such an extension for the applicable timely filed S corporation income tax return.

By Notice of Deficiency dated December 4, 1987, the Respondent disallowed, inter alia, the Petitioner's claimed 1979 loss and investment credit attributable to the S corporation for its taxable period December 26, 1978 through November 30, 1979.

The Petitioner invoked the jurisdiction of the United States Tax Court under sections 6213(a) and 6214(a) of the Internal Revenue Code of 1986 challenging the statutory Notice of Deficiency issued by the Respondent. Judge Meade Whitaker entered a decision in favor of the Respondent, reported at 61 T.C.M. (CCH) 2410 (1991), in the case on May 14, 1991. Judge Whitaker decided that the Respondent need only obtain an extension of the period of limitations for an individual shareholder's income tax return to make adjustments on that return with respect to S corporation items of income or loss, even though the three-year statute of limitations period for the S corporation income tax return had expired.

The Petitioner then invoked the United States Court of Appeals for the Second Circuit's jurisdiction under sections 7482(a)(1) and (b)(1)(a) of the Internal Revenue Code of 1986. The Second Circuit affirmed the Tax Court and, relying on its decision in Siben v. Commissioner, 930 F.2d 1034 (2nd Cir. 1991), cert. denied, 112 S. Ct. 429 (1991), held "that the relevant return for purposes of determining the statute of limitations is the return of the

taxpayer against whom the tax is sought." Bufferd v. Commissioner, 952 F.2d 675, 678 (2nd Cir. 1992). The Second Circuit reasoned that Section 6501(a) of the Code (which provides the limitations period for the assessment of taxes) only bars the assessment of tax on an entity more than three years after the filing of the entity's return. It "does not bar adjustments to an entity's return that do not result in a tax assessment on that entity." Bufferd, 952 F.2d at 677. In so holding, the Second Circuit rejected the Petitioner's policy argument that, given the fact that the S corporation could destroy its records after the statute of limitations expires, a taxpayer would be unable to defend itself against a deficiency imposed by the Respondent after the statute of limitations had expired. The Court felt that taxpayers can take protective steps to ensure that the S corporation doesn't destroy its records.

REASONS FOR GRANTING THE WRIT

I.

The Second Circuit's holding that separate waivers of the statute of limitations are not required for both a S corporation and its shareholders is in conflict with the decisions of other Circuits and subverts the separate-entity doctrine of Moline.

In a recently decided case, the Eleventh Circuit agreed with the Second Circuit that separate waivers of the statute of limitations are not required for both a S corporation and its shareholders. Fehlhaber v. Commissioner, 94 T.C. No. 54 (1990), aff'd 954 F.2d 653 (11th Cir. 1992).

In conflict with these decisions is Kelley v. Commissioner, T.C. Memo 1986-405, rev'd 877 F.2d 756 (9th Cir. 1989). In that

case, the Ninth Circuit reversed the Tax Court's decision and held that the "the IRS may not adjust a shareholder's return based on an adjustment to an S corporation's return when the statute of limitations has run on the S corporation's return." 877 F.2d at 759.

The Eight Circuit cited the Kelley decision in Fendell v. Commissioner, 906 F.2d 362 (8th Cir. 1990), and held that "the expiration of the limitations period for auditing the trust's returns barred adjustment of the amount of distributions claimed on the beneficiaries' individual returns." According to the Fendell court, the Ninth Circuit Kelley case and similar cases such as Illinois Masonic Home v. Commissioner, 93 T.C. 145 (1989) and Boatmen's First Nat'l Bank v. United States, 705 F. Supp. 1407 (W.D. Mo. 1988) "embody the principle that in order for the Commissioner to adjust tax liability, he must be able to do so at the source of the income . . . or [he] will be prevented from doing so at the point where the income is distributed." Fendell, 906 F.2d at 364. Since S corporation shareholders and the S corporation, like beneficiaries and the trust, are separate taxable entities, no adjustments on the shareholders' individual returns can be made with respect to S corporation items if the S corporation's limitations period has expired.

In addition to creating conflict with other Circuits, the decision below subverts the separate-entity doctrine of Moline.

As stated by this Court in Moline Properties, Inc. v. Comm'r., 319 U.S. 436 (1943):

> The doctrine of corporate entity fills a useful purpose in business life . . . so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. 319 U.S. at 438.

However, despite this Court's recently expressed concern "that the separate-entity doctrine of Moline not be subverted," Commissioner v. Bollinger, 485 U.S. 340 (1988), the decision below, in fact, disregards the S corporation's existence as distinct from that of its shareholders.

Section 6037(a) of the Code requires a S corporation to file a return. The section goes on to say that the return will be considered a corporate return when determining the applicable statutory period of assessment.

Section 6012(a)(2) of the Code also requires every corporation subject to income taxes under subtitle A to file a return. Reading section 6012(a)(2) in conjunction with section 6037(a), the return filed by a S corporation must be treated as an income tax return of the corporation for the purpose of establishing the appropriate statute of limitations period.

Section 6501(a) of the Code contains the statute of limitations rule for examination and assessment of a tax on a corporate return. It states in pertinent part: "Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed . . . ." By holding that a S corporations's shareholder's tax return is the relevant return with regard to items that appear on the S corporation's income tax return, the Second Circuit disregards the S corporation's income tax return. The conflict between Moline and the instant case is thus apparent and deserves

this Court's attention.

The Second Circuit has created a precedent which conflicts with decisions of this Court and other circuits and is likely to create further litigation and confusion in circuits yet to resolve this issue.

II.

The decision below that an adjustment made to a S corporation's return, after the statute of limitations has run, can form the basis for an adjustment to the S corporation's shareholders' returns raises important and unresolved problems which are likely to generate further litigation.

The Kelley decision is predicated largely on the concept of finality. As the Kelley court stated, "the statute of limitations exists in part so that after some time persons can be confident that their affairs are closed and that they can dispose of old records." Kelley, 877 F.2d at 758. If a shareholder cannot be confident that the statute of limitations has run on the S corporation's income tax return, the shareholder cannot be confident that his individual return is final for that particular year with respect to S corporation items. Such a result negates the concept of finality because shareholders would not know when "their affairs are closed." Kelley, 877 F.2d at 758.

The Internal Revenue Service is also entitled to finality. If the precedent set below is allowed to stand, it could impact on the Service's ability to collect revenue. If, for example, an S corporation sought to amend its income tax return to reduce reported income or increase its loss after three years from filing its return, the Service could not bar the amendment's effect on

shareholders because the limitations period had run for the corporation. As long as a shareholder's return remains open, an individual shareholder, like the Appellant, could amend his individual return to reduce income or claim increased losses despite the Service's inability to examine the S corporation's income tax return. Although this result is absurd, it is a logical outcome of the decision in the case below.

Finally, the Petitioner notes the existence of other litigation involving this issue (Brody v. Commissioner, 61 T.C.M. (CCH) 1993, appeal docketed, No.91-4497 (Fifth Circuit, June 17, 1991)). Summary judgment on this issue was entered in Aries v. Commissioner, 61 T.C.M. (CCH) 1769 (1991), interlocutory appeal denied, No. 3827-89, 3841-89 (Tax Court, May 22, 1991).

Lower courts thus need guidance from this Court on the question of whether an adjustment made to a S corporation's return, after the statute of limitations has run, can form the basis for an adjustment to the S corporation's shareholders' returns.

CONCLUSION

For the reasons stated above, this petition for certiorari should be granted.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 214—August Term, 1991

(Argued September 25, 1991 Decided January 3, 1992)

Docket No. 91-4099

SHELDON B. BUFFERD; PHYLLIS BUFFERD,

Petitioners-Appellants,

—v.—

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Before:

MESKILL, WINTER and ALTIMARI,

Circuit Judges.

Appeal from a decision by the United States Tax Court determining that the Commissioner of Internal Revenue timely assessed a deficiency on petitioner's individual income tax payment arising from his distributive share in the income of an S corporation.

Affirmed.

STUART J. FILLER, University of Bridgeport School of Law Tax Clinic, Bridgeport, CT (Toni Robinson, Joseph A. Kubic, Craig H. Rein, University of Bridgeport School of Law Tax Clinic, Bridgeport, CT, of counsel), *for Appellants*.

JANET K. JONES, Tax Division, Department of Justice, Washington, D.C. (Shirley D. Peterson, Assistant Attorney General, Gary R. Allen, Robert S. Pomerance, Tax Division, Department of Justice, Washington, D.C., of counsel), *for Appellee*.

MESKILL, *Circuit Judge*:

Sheldon Bufferd appeals from a decision of the United States Tax Court imposing a tax deficiency on him for the year 1979. The sole issue on appeal is whether the Commissioner of Internal Revenue (Commissioner) timely assessed the deficiency. The tax court held that the Commissioner was not barred by the limitation provision of the Internal Revenue Code.

We affirm.

BACKGROUND

In 1979 Sheldon B. Bufferd was a shareholder in Compo Financial Services, Inc., an electing small business corporation under Subchapter S of the Internal Revenue Code. 26 U.S.C. § 1371 *et seq.* (1954 Act) (unless otherwise noted, all references are to the Internal Revenue Code of 1954 as amended and effective during the years in issue). Bufferd and Compo were two of several partners in a venture known as Printer's Associates (Printer's). Printer's reported substantial losses in 1979 arising from a failed investment in a new technology. Compo reported a loss from the Printer's partnership on its 1979 small business corporation income tax return. Bufferd and his wife filed a joint income tax return in 1979. In that return they reported a loss from the Printer's partnership. The Bufferds also reported their distributive share of Compo's loss on their 1979 return.

In March 1983 the Bufferds and a representative of the Commissioner executed a form entitled "Special Consent to Extend the Time to Assess Tax" (Form 872-A). The document provided that, regardless of the statute of limitations, the Commissioner could assess income tax due on the Bufferds' 1979 return at any time prior to ninety days after revocation of the consent by the Bufferds. The document contained a proviso limiting any such deficiency assessment to that resulting from adjustments to the Bufferds' distributive share from, basis in or sale of any interest in "any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's return)." The Bufferds never revoked the consent to the extension of time. Compo never assented to an extension of time to assess the tax due for 1979.

The Commissioner subsequently determined that the losses reported by Printer's were improper. The Commissioner thus made adjustments to the Bufferds' 1979 return by disallowing the partnership loss. The Commissioner also adjusted Compo's return to reflect the disallowance of Printer's losses. Bufferd's distributive share from Compo was thus altered from a $500 loss to a $1,418 gain. Bufferd's wife settled separately with the Commissioner following her divorce from petitioner.

Bufferd ultimately agreed to the deficiency assessed by the Commissioner to the extent of the disallowance of the direct partnership loss. Bufferd argued, however, that the Commissioner could not assess a deficiency with regard to the Compo adjustment because the statute of limitations had run with respect to Compo's tax liability.

The tax court determined that the Form 872-A executed by petitioner defeated Bufferd's statute of limitations defense. Thus the tax court ordered Bufferd to pay the full amount of the deficiency. Bufferd appeals that decision.

DISCUSSION

Bufferd contends that the Commissioner could not properly have made any adjustments to his return that result from adjustments to Compo's return because the limitations period with respect to Compo had expired and no extension of that period had been executed. The Commissioner urges that we affirm the tax court, which held that the relevant limitations period for purposes of assessing the tax due on the Bufferds' 1979 joint return was the period directly associated with that return. We agree with the Commissioner and the tax court on this point.

26 U.S.C. § 6501(a) provides the limitations period for the assessment of taxes. That section provides in pertinent part that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed." An exception to this limitations period is provided where the Secretary and the taxpayer consent in writing to an extension of time. 26 U.S.C. § 6501(c)(4).

At the heart of this dispute is the meaning of the word "return" in section 6501(a). The Commissioner claims that that term refers to the return of the taxpayer against whom the Commissioner has imposed the deficiency. Bufferd claims that, in the context of a gain or loss resulting from an adjustment to the return of an S corporation, the return of the S corporation is the relevant return.

We recently addressed the meaning of "return" in section 6501(a). In *Siben* v. *C.I.R.*, 930 F.2d 1034 (2d Cir. 1991), *cert. denied*, 112 S.Ct. 429 (1991), the Commissioner had made an adjustment to an individual partner's return based on alterations to the partnership return. The taxpayer argued that because the statute of limitations had run with respect to the partnership, the Commissioner was barred from adjusting the individual partner's distributive share of the partnership's income. We stated that

> it appears to us that the "return" that starts the running of the limitations period at issue is that of the taxpayer whose liability is being assessed, and not that of a third person or entity whose return might also report the transaction that gives rise to the liability. On this reading, the return referred to in § 6501(a) would thus be the individual's income tax return for an assessment of individual income tax.

Id. at 1035.

Bufferd argues that because the "third person or entity" at issue here is an S corporation rather than a partnership, *Siben* is inapplicable. Bufferd points to 26 U.S.C. § 6037, which states in pertinent part that a return filed by an S corporation "shall, for purposes of chapter 66, (relating to limitations) [and containing section 6501(a)], be treated as a return filed by the corporation under section 6012." The statute that requires partnerships to file returns, 26 U.S.C. § 6031, has no similar provision relating to the effect of those returns on the limitations period.

Bufferd urges that in interpreting the effect of section 6037 on section 6501(a) we adopt the reasoning of *Kelley* v. *C.I.R.*, 877 F.2d 756 (9th Cir. 1989). In *Kelley* the Ninth Circuit held that those sections bar the Commissioner from adjusting a shareholder's return based on an adjustment to an S corporation's return when the limitations period has run on the S corporation's return. *Id.* at 759. The court noted that section 6501 barred any adjustments to corporate returns after the limitations period. Section 6037 mandates that S corporation returns be treated as corporate returns for purposes of limitations. Therefore, reasoned the *Kelley* Court, returns of S corporations could not be adjusted in any way after the limitations period had run.

We disagree with *Kelley*'s interpretation of section 6501(a). That section bars only the assessment of a tax on an entity more than three years after the entity has filed a return. Section 6501(a) does not bar adjustments to an entity's return that do not result in a tax assessment on that entity. An adjustment to the return of an S corporation that does not impose tax liability on that S corporation is not barred by sections 6501(a) and 6037.

Bufferd argues that if we do not interpret section 6037 as he proposes we will effectively eliminate that section from the statute. We disagree. Section 6037 provides the limitations period for organizations that file returns as S corporations but are nonetheless required to pay some tax on the organization's income. For example, if an organization was not entitled to elect to become an S corporation, any tax on the organization's income as a normal corporation must be assessed within three years of the filing of the S corporation return. *Fehlhaber* v. *C.I.R.*, 94 T.C. 863 (1990) (quoting S. Rep. No. 1983, 85th Cong. 2nd Sess. (1958), 1958-3 C.B. 922, 1147). In this respect the final phrase in section 6037 performs for S corporations a function similar to that performed by section 6501(g) for trusts, exempt organizations and Domestic International Sales Corporations.

Moreover, valid S corporations on occasion are required to pay tax on certain types of income. *See* 26 U.S.C. § 1374 (imposing tax on certain capital gains by S corporations). Section 6037 provides that in such cases the filing of an S corporation return triggers the limitations period for imposition of this direct tax against the S corporation. Section 6037 therefore retains ample meaning even bereft of the interpretation proposed by Bufferd.

Bufferd also argues that if the limitations period of the S corporation does not govern the assessment of tax on a shareholder's distributive share derived from that S corporation, the taxpayer will be unable to defend itself effectively against any deficiency imposed by the Commissioner. Bufferd argues that the S corporation could destroy the books and records necessary for such a defense after its limitations period had passed. In *Siben* we held that "a taxpayer can generally protect himself by taking steps to ensure that the partnership preserves records needed to support the partnership item claimed on the individual partner's return." 930 F.2d at 1037. We believe that a shareholder of an S corporation can take similar protective steps with regard to the S corporation records needed to support the S corporation items claimed on the shareholder's return.

We find the words of section 6501(a) clear and unambiguous. Barring an exception, if the Commissioner wishes to assess a tax on an entity, he must do so within three years after the filing by that entity of the return on which the tax should have been reported. We do not

believe that section 6037 can fairly be read in the manner proposed by Bufferd.

The relevant return for purposes of section 6501(a) is Bufferd's joint return rather than Compo's S corporation return. The Form 872-A executed in March 1983 by the Bufferds gave the Commissioner the power to assess income tax due on the Bufferds' 1979 return any time prior to ninety days after Bufferd terminated the consent. The printed form also contains a typewritten proviso that limits any deficiency assessment to that resulting from adjustment to the Bufferds' distributive share from, basis in, or sale of any interest in "any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's return)."[1]

Compo Financial Services, Incorporated, was not a partnership and Bufferd did not treat it as a partnership on his 1979 joint return. The extension granted the Commissioner by Bufferd does not by its terms reach the assessment of taxes resulting from an adjustment to Bufferd's distributive share from Compo.

However, Bufferd did not raise this theory before the tax court. In fact, Bufferd arguably waived this argument through the stipulations filed before the tax court. Because of these considerations, and because Bufferd did not press this argument on appeal, even after a request for additional briefing on the issue by this Court, we do not reach that issue. We consider the extension applicable to the income at issue here.

CONCLUSION

We agree with the tax court that the relevant return for purposes of determining the statute of limitations is the return of the taxpayer against whom the tax is sought. We therefore affirm the judgment of the tax court.

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1 The entire proviso states:

> (5) The amount of any deficiency assessment is to be limited to that resulting from any adjustment to: (a) the taxpayer's distributive share of any item of income, gain, loss, deduction, or credit of, or distribution from *any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's tax return)*; (b) the tax basis of the taxpayer's interest(s) in such partnership(s) or organization(s) treated by the taxpayer as a partnership; and (c) any gain or loss (or the character or timing thereof) realized upon the sale or exchange, abandonment, or other disposition of taxpayer's interest in such partnership(s) or organization(s) treated by the taxpayer as a partnership, including any consequential changes to other items based on such adjustment.

(emphasis added).

MEMORANDUM FINDINGS OF FACT AND OPINION

WHITAKER, Judge: Respondent determined deficiencies and additions to tax in petitioners' Federal income tax as follows:

Year	Deficiency	Addition to Tax Section 6653(a)[1]
1975	$ 3,069	$153.45
1976	3,704	185.20
1977	6,291	314.55
1978	13,859	692.95
1979	12,555	627.75

After concessions, the sole issue for decision is whether the statute of limitations relating to the assessment of an income tax deficiency determined against the shareholder of a subchapter S corporation is to be measured at the corporate level or at the shareholder level. We are bound to follow our Court-reviewed opinion in Fehlhaber v. Commissioner, 94 T.C. 863 (1990). Therefore, we hold that the notice of deficiency mailed to petitioners on December 4, 1987, was timely under section 6501(a) and the assessment is not barred by the statute of limitations.

FINDINGS OF FACT

This case was submitted for decision under Rule 122. The stipulations and attached exhibits are incorporated herein by this reference.

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[1] Unless otherwise noted, all section references are to the Internal Revenue Code of 1954 as amended and in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Petitioner, Sheldon B. Bufferd, resided in Fairfield, Connecticut, at the time the petition was filed. Petitioner, Phyllis Bufferd, resided in Westport, Connecticut, at the time the petition was filed.

The concessions in this case are as follows: (1) For the 1978 taxable year, petitioner is entitled to an ordinary deduction in the amount of $20,000 which is equal to his cash investment in Printer Associates; (2) petitioner is not entitled to any other losses or credits attributable to Printer Associates for any year; (3) Mrs. Bufferd is not liable for any deficiencies for the taxable years 1975 through 1979 pursuant to section 6013(e); (4) Mrs. Bufferd is not liable for additions to tax for the taxable years 1975 through 1979 under sections 6653(a) and 6659 pursuant to section 6013(e); (5) Mrs. Bufferd is not liable for the increased rate of interest under section 6621(c) for the taxable years 1975 through 1979 pursuant to section 6013(e); (6) Mr. Bufferd is not liable for additions to tax for the taxable years 1975 through 1979 under sections 6653(a) and 6659, and (7) Mr. Bufferd is liable for the increased rate of interest under section 6621(c) for the taxable years 1975 through 1979.

The facts that are relevant to the statute of limitation issue remaining is this case are as follows. In 1979 Mr. Bufferd (hereinafter petitioner) was a shareholder in Compo Financial Services, Ltd. (Compo). In 1979 Compo was an electing small business corporation within the meaning of section 1371(a).

Compo timely filed a U.S. Small Business Corporation Income Tax Return (Form 1120S) for the taxable period December 26, 1978, through November 30, 1979, on February 1, 1980. Compo did not extend the statute of limitations for assessment of taxes as provided under section 6501(c)(4) with respect to its taxable period ended November 30, 1979. On December 21, 1983, petitioner, in his capacity as secretary/treasurer of Compo executed a Special Consent to Extend the Time to Assess Tax (Form 872-A) with respect to the taxable period ended November 30, 1980. On December 15, 1987, respondent executed a Notice of Termination of Special Consent to Extend the Time to Assess Tax (Form 872-T) with respect to Form 872-A dated July 22, 1985, executed by the parties with respect to Compo's taxable period ended November 30, 1982.

On April 15, 1980, petitioners filed their Federal income tax return for the 1979 taxable year. Petitioners reported their income and deductions for the 1979 taxable year on the basis of cash receipts and disbursements. On petitioners' 1979 tax return, they claimed an ordinary loss in the total amount of $11,550 ($11,050 with respect to Printer Associates and $500 with respect to Compo). On petitioners' 1979 tax return, they also claimed an investment credit with respect to Compo in the amount of $8,023.

On March 7, 1983, petitioners timely executed a Form 872-A for their 1979 taxable year. Respondent executed Form 872-A on

March 15, 1983. Neither petitioners nor respondent filed a Form 872-T with respect to petitioners' 1979 taxable year.

In the statutory notice of deficiency dated December 4, 1987, respondent disallowed petitioners' claimed 1979 loss and investment credit attributable to Compo for its taxable period December 26, 1978, through November 30, 1979. Respondent further determined that petitioner's distributive share of Compo income in 1979 was $1,418, resulting in a total adjustment with respect to Compo in the amount of $1,918. The statutory notice was timely sent to petitioners prior to the expiration of the 3-year period for assessment with respect to petitioners' 1979 tax return, as duly and timely extended under Form 872-A. The statutory notice was issued to petitioners more than 3 years after the filing of Compo's Form 1120S for the taxable period ended November 30, 1979, for which an extension of the assessment period was not executed by the corporation.

OPINION

This issue was previously considered by this Court in Kelley v. Commissioner, T.C. Memo. 1986-405. In Kelley, this Court held that the statute of limitations on assessment of a deficiency resulting from the disallowance of a loss flow-through from a subchapter S corporation is measured with reference to the individual shareholder's income tax return, rather than the corporation's information return. This Court's decision in Kelly was subsequently reversed in Kelly v. Commissioner, 877 F.2d 756

(9th Cir. 1989). In Fehlhaber v. Commissioner, 94 T.C. 863 (1990), we reconsidered our opinion in Kelley, in view of the reversal by the United States Court of Appeals for the Ninth Circuit. In Fehlhaber, we concluded that our holding in Kelley was correct and, therefore, we would adhere to our conclusion reached in Kelley. In Fehlhaber, we respectfully declined to follow the decision of the Court of Appeals for the Ninth Circuit on this issue where the appeal lies to another circuit. See Golsen v. Commissioner, 54 T.C. 742, 756-757 (1970), affd. 445 F.2d 985 (10th Cir. 1971). The appeal in this case lies in the Second Circuit. Therefore, we are bound to follow our Court-reviewed opinion in Fehlhaber. Accordingly, we hold that the notice of deficiency mailed to petitioners on December 4, 1987, was timely under section 6501(a) and, therefore, the assessment is not barred by the statute of limitations.

Decision will be entered under Rule 155.

EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

Internal Revenue Service
District Director

Department of the Treasury

Date: DEC 04 1987

S.S.N or E. .No.: 049-32-7803
Tax Year Ended and Deficiency:

See
Attached
Form
4089

Sheldon B Bufferd & Phyllis Bufferd
11 Oak Lane
Weston, CT 06880

Person to Contact: Edward K. Clark
Telephone No.: (603) 433-0749

We have determined that there is a deficiency (increase) in your income tax as shown above. This letter is a NOTICE OF DEFICIENCY sent to you as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this deficiency in court before making any payment, you have 90 days from the above mailing date of this letter (150 days if addressed to you outside of the United States) to file a petition with the United States Tax Court for a redetermination of the deficiency. The petition should be filed with the United States Tax Court, 400 Second Street NW., Washington, D.C. 20217, and the copy of this letter should be attached to the petition. The time in which you must file a petition with the Court (90 or 150 days as the case may be) is fixed by law and the Court cannot consider your case if your petition is filed late. If this letter is addressed to both a husband and wife, and both want to petition the Tax Court, both must sign the petition or each must file a separate, signed petition.

If you dispute not more than $10,000 for any one tax year, a simplified procedure is provided by the Tax Court for small tax cases. You can get information about this procedure, as well as a petition form you can use, by writing to the Clerk of the United States Tax Court at 400 Second Street NW., Washington, D.C. 20217. You should do this promptly if you intend to file a petition with the Tax Court.

If you decide not to file a petition with the Tax Court, we would appreciate it if you would sign and return the enclosed waiver form. This will permit us to assess the deficiency quickly and will limit the accumulation of interest. The enclosed envelope is for your convenience. If you decide not to sign and return the statement and you do not timely peti ion the Tax Court, the law requires us to assess and bill you for the deficiency after 90 days from the above mailing date of this letter (150 days if this letter is addressed to you outside the United States).

If you have any questions, please contact the person whose name and address are shown on the letter. If you write, please attach this letter to help identify your account. Keep the copy for your records. Also, please include your telephone number and the most convenient time for us to call, so we can contact you if we need additional information.

If you prefer, you may call the IRS contact person at the telephone number shown above. If this number is outside your local calling area, there will be a long distance charge to you.

You may call the IRS telephone number listed in your local directory. An IRS employee there will be able to help you, but the contact person at the address shown on this letter is most familiar with your case.

Thank you for your cooperation.

Sincerely yours,

Lawrence Gibbs

Commissioner
By

Donald Mintzer

District Director

Enclosures:
Copy of this letter
Statement
Envelope

January 1983)

Notice of Deficiency-Waiver

ESP: EXC

DEC 04 1987

Name,SSN or EIN, and Address of Taxpayer(s)

049-32-7803 Sheldon B Bufferd & Phyllis Bufferd
11 Oak Lane
Weston, CT 06880

Kind of Tax: INCOME

[ ]Copy to Authorized Representative

Deficiency

Tax Year Ended	Increase in Tax	Penalties
December 31, 1975	$3,069.00	$153.45 Sec 6653(A)(1) IRC
December 31, 1976	$3,704.00	$185.20 Sec 6653(A)(1) IRC
December 31, 1977	$6,291.00	$314.55 Sec 6653(A)(1) IRC
December 31, 1978	$13,859.00	$692.95 Sec 6653(A)(1) IRC
December 31, 1979	$12,555.00	$627.75 Sec 6653(A)(1) IRC

See the attached explanation for the above deficiencies

I consent to the immediate assessment and collection of the deficiencies(increase in tax and penalties) shown above, plus any interest provided by law.

Your Signature ..... (Date signed)

Spouse's Signature, If A Joint Return Was Filed ..... (Date signed)

Taxpayer's Representative Sign Here ..... (Date signed)

Corporate Name: .....

Corporate Officers ..... (Signature) (Title) (Date signed)

Sign Here ..... (Signature) (Title) (Date signed)

Note: If you consent to the assessment of the amounts shown in this waiver, please sign and return it in order to limit the accumulation of interest and expedite our bill to you. Your consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are entitled to a refund. It will not prevent us from later determining, if necessary, that you owe additional tax; nor will it extend the time provided by law for either action.

If you later file a claim and the Internal Revenue Service disallows it, you may file suit for refund in a district court or in the United States Claims Court, but you may not file a petition with the United States Tax Court.

Who Must Sign

If this waiver is for any year(s) for which you filed a joint return, both you and your spouse must sign the original and duplicate of this form. Sign your name exactly as it appears on the return. If you are acting under power of attorney for your spouse, you may sign as agent for him or her.

For an agent or attorney acting under a power of attorney, a power of attorney must be sent with this form if not previously filed.

For a person acting in a fiduciary capacity (executor, administrator, trustee), file Form 56, Notice Concerning Fiduciary Relationship, with this form if not previously filed.

For a corporation, enter the name of the corporation followed by the signature and title of the officer(s) authorized to sign.

If you agree, please sign one copy and return it; keep the other copy for your records.

Sheldon B Bufferd & Phyllis Bufferd ATTACHMENT TO FORM 4089

8103

It is determined that part of the underpayment of tax for the taxable years ended December 31, 1975, 1976, 1977, 1978, & 1979 is due to negligence or intentional disregard of rules and regulations; therefore the five percent addition to the tax provided by section 6653(a) of the Internal Revenue Code of 1954 is asserted for that year.

9436

The entire underpayment of your income tax for the years 1975, 1976, 1977, 1978, & 1979 is a substantial underpayment attributable to tax motivated transactions under Section 6621(c) of the Internal Revenue Code.

Accordingly, the annual rate of interest payable on your income tax for the tax year 1975, 1976, 1977, 1978, & 1979 resulting from the substantial underpayment of tax attributable to tax motivated transactions shall be 120 percent of the adjusted rate established under Section 6621(b) of the Internal Revenue Code.

(O)

All or part of the underpayment of tax for the tax years 1975, 1976, 1977, 1978, and 1979 is attributable to a valuation overstatement. The amount of the underpayment due to the valuation overstatement is $3,069.00, $3,704.00, $6,291.00, $13,859.00, and $12,555.00, respectively, and is attributable to the items marked (O) on the attached form 1902-B. Consequently, the 30 percent addition to the tax so attributable for that year is asserted, as provided by Section 6659 of the Internal Revenue Code.

Report of Individual Income Tax Examination Changes

Department of the Treasury
Internal Revenue Service

Name of Taxpayer	Year	Form	Filing Status	In Reply Refer To:
SHELDON B + PHYLLIS BUFFERD	7512	1040	JOINT	ESP:E*C
Name and Title of Person With Whom Changes Were Discussed	Date of Report		Social Security Number	Examining District
			049-32-7803	08

Income and Deduction Amounts Adjusted

Explanation No. (See attached)	Item Changed	Amount Shown on Return or as Previously Adjusted	Corrected Amount of Income and Deduction	Adjustment Increase (Decrease)
# 1	1978 INVESTMENT CREDIT C/B	–	–	–
# 2	TAX MOTIVATED TRANSACTION		–	–
# 3	NEGLIGENCE		–	–

A. Adjustment in income-increase (decrease) (see explanation of adjustments attached)	–
B. Adjusted gross, taxable, or tax table income reported or as previously adjusted	15746.00
C. Corrected adjusted gross, taxable, or tax table income	15746.00
D. Tax computed with exemptions	3196.00
E. Credit for personal exemptions	120.00
F. Tax credits (credit for the elderly, investment, foreign, or other allowable credits) (if adjusted, see explanation attached)	7.00
G. Other taxes (self-employment, minimum, alternative minimum, tax from recomputing prior year investment credit, advance earned income credit payments, etc.) (if adjusted, see explanation attached)	1114.00
H. Corrected tax (line D less line E less line F plus line G)	4183.00
I. Tax shown on return or as previously adjusted	1114.00
J. Deficiency (increase in tax before credit adjustments – line H less line I)	3069.00
K. Overassessment (decrease in tax before credit adjustments – line I less line H)	
L. Adjustments to prepayment credits	
M. Balance due – this does not include any interest charges (line J or K as adjusted by line L)	3069.00
N. Overpayment – this does not include any interest due you (line J or K as adjusted by line L)	
O. Penalties, if any (see explanation attached) VALUATION OVERSTATEMENT 6659 NEG PENALTY 6653(A)(1)	920.70 163.45

15a

Report of Individual Income Tax Examination Changes

Department of the Treasury
Internal Revenue Service

Name of Taxpayer	Year	Form	Filing Status	In Reply Refer To:
SHELDON B & PHYLLIS BUFFERD	7612	1040	JOINT	ESP:E*C
Name and Title of Person With Whom Changes Were Discussed	Date of Report		Social Security Number	Examining District
			049-32-7803	C.P.

Income and Deduction Amounts Adjusted

Explanation No. (See attached)	Item Changed	Amount Shown on Return or as Previously Adjusted	Corrected Amount of Income and Deduction	Adjustment Increase (Decrease)
# 1	1978 INVESTMENT CREDIT C/B + NEW JOBS CREDIT		–	–
# 2	TAX MOTIVATED TRANSACTION		–	–
# 3	NEGLIGENCE	–	–	–

A. Adjustment in income-increase (decrease) (see explanation of adjustments attached)	–
B. Adjusted gross, taxable, or tax table income reported or as previously adjusted	18268.00
C. Corrected adjusted gross, taxable, or tax table income	18268.00
D. Tax computed with exemptions	3897.00
E. Credit for personal exemptions	180.00
F. Tax credits (credit for the elderly, investment, foreign, or other allowable credits) (if adjusted, see explanation attached)	13.00
G. Other taxes (self-employment, minimum, alternative minimum, tax from recomputing prior year investment credit, advance earned income credit payments, etc.) (if adjusted, see explanation attached)	1209.00
H. Corrected tax (line D less line E less line F plus line G)	4913.00
I. Tax shown on return or as previously adjusted	1209.00
J. Deficiency (increase in tax before credit adjustments – line H less line I)	3704.00
K. Overassessment (decrease in tax before credit adjustments – line I less line H)	
L. Adjustments to prepayment credits	
M. Balance due – this does not include any interest charges (line J or K as adjusted by line L)	3704.00
N. Overpayment – this does not include any interest due you (line J or K as adjusted by line L)	
O. Penalties, if any (see explanation attached) VALUATION OVERSTATEMENT NEG PENALTY 6653(A)(1) 6659	111.20 185.20

16a

:eport of Individual
:ncome Tax Examination C[illegible]nges

Department of the Treasury
Internal Revenue Service

Name of Taxpayer	Year	Form	Filing Status	In Reply Refer To:
SHELDON B + PHYLLIS BUFFERD	7712	1040	JOINT	ESP:EKC
Name and Title of Person With Whom Changes Were Discussed	Date of Report		Social Security Number	Examining District
			049-32-7803	08

Income and Deduction Amounts Adjusted

Explanation No. (See attached)	Item Changed	Amount Shown on Return or as Previously Adjusted	Corrected Amount of Income and Deduction	Adjustment Increase (Decrease)
# 1	INVESTMENT/JOBS CREDIT CARRYBACK FROM 1978+1979	-		-
# 2	TAX MOTIVATED TRANSACTIONS			-
# 3	NEGLIGENCE			-

A. Adjustment in income increase (decrease) (see explanation of adjustments attached)	-
B. Adjusted gross, taxable, or tax table income reported or as previously adjusted	33572.00
C. Corrected adjusted gross, taxable, or tax table income	33572.00
D. Tax computed with exemptions	6621.00
E. Credit for personal exemptions	180.00
F. Tax credits (credit for the elderly, investment, foreign, or other allowable credits) (if adjusted, see explanation attached)	150.00
G. Other taxes (self-employment, minimum, alternative minimum, tax from recomputing prior year investment credit, advance earned income credit payments, etc.) (if adjusted, see explanation attached)	1379.00
H. Corrected tax (line D less line E less line F plus line G)	7670.00
I. Tax shown on return or as previously adjusted	1379.00
J. Deficiency (increase in tax before credit adjustments—line H less line I)	6291.00
K. Overassessment (decrease in tax before credit adjustments—line I less line H)	
L. Adjustments to prepayment credits	
M. Balance due – this does not include any interest charges (line J or K as adjusted by line L)	6291.00
N. Overpayment – this does not include any interest due you (line J or K as adjusted by line L)	
O. Penalties, if any (see explanation attached) VALUATION OVERSTATEMENT 6659 - 1887.30 NEG PENALTY 6653(A)(1) 314.55	

AND ADDRESS OF TAXPAYER:	DATE OF REPORT:
[illegible]DON B & PHYLLIS BUFFERD	SOC. SEC. NUMBER: 049-32-7803
[illegible]1 OLD ACADEMY ROAD	FORM: 1040
[illegible]IRFIELD, CT 06430	YEAR: 1978
	FILING STATUS: JOINT
[illegible]ME AND TITLE OF PERSON WITH WHOM [illegible]HANGES WERE DISCUSSED:	EXAMINING DISTRICT: 008
	NAME OF EXAMINER:
	IN REPLY REFER TO: ESP:EKC

EXPLANATION NUMBERS		INCOME AND DEDUCTION AMOUNTS ADJUSTED		ADJUSTMENT INCREASE (DECREASE)
629	(T)	PRINTER ASSOCIATES		8,950.00
911		SCHEDULE G		
221	(T)	INVESTMENT TAX CREDIT		
308		TARGETED JOBS CREDIT		
418		CREDIT FOR PERSONAL EXEMPTIONS		(3,000.00)
103		PENALTIES		
436		TAX MOTIVATED TRANSACTIONS		
. ADJUSTMENTS TO INCOME AND/OR DEDUCTIONS - INCREASE				5,950.00
. PLUS TAX TABLE INCOME AS SHOWN ON RETURN				51,087.00
. CORRECTED TAXABLE INCOME				57,037.00
. TAX COMPUTED WITH 4 EXEMPTIONS			TAX RATE SCHEDULE	19,034.00
. GENERAL TAX CREDIT				180.00
. LESS TAX CREDITS:				
INVESTMENT TAX CREDIT				21.00
TARGETED JOBS CREDIT				4,974.00
. PLUS OTHER TAXES:				
SELF EMPLOYMENT TAX			1,434.00	
TOTAL OTHER TAXES				1,434.00
. CORRECTED TAX CARRIED TO NEXT PAGE				15,293.00

E, AND ADDRESS OF TAXPAYER:	DATE OF REPORT:	
ELDON B & PHYLLIS BUFFERD	SOC. SEC. NUMBER:	049-32-7803
231 OLD ACADEMY ROAD	FORM:	1040
AIRFIELD, CT 06430	YEAR:	1978
	FILING STATUS:	JOINT
AME AND TITLE OF PERSON WITH WHOM	EXAMINING DISTRICT:	008
HANGES WERE DISCUSSED:	NAME OF EXAMINER:	
	IN REPLY REFER TO:	ESP:EMC

. CORRECTED TAX FROM PRECEDING PAGE	15,293.00
. LESS TAX AS SHOWN ON RETURN	1,434.00
. DEFICIENCY	13,859.00
. BALANCE DUE	13,859.00
. PENALTIES: NEGLIGENCE, SEC. 6653(A)(1) I.R.C.	692.95

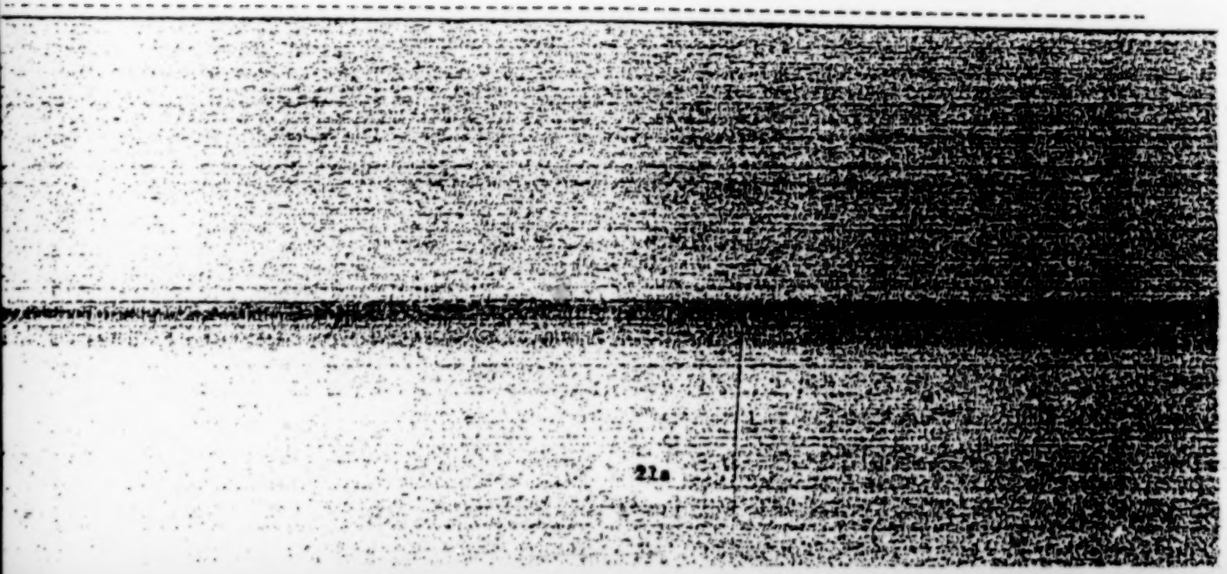
& AND ADDRESS OF TAXPAYER:	DATE OF REPORT:	
ELDON B & PHYLLIS BUFFERD	SOC. SEC. NUMBER:	049-32-7803
231 OLD ACADEMY ROAD	FORM:	1040
AIRFIELD, CT 06430	YEAR:	1979
	FILING STATUS:	JOINT
AME AND TITLE OF PERSON WITH WHOM	EXAMINING DISTRICT:	008
HANGES WERE DISCUSSED:	NAME OF EXAMINER:	
	IN REPLY REFER TO:	ESP:EMC

EXPLANATION UNDERS		INCOME AND DEDUCTION AMOUNTS ADJUSTED		ADJUSTMENT INCREASE (DECREASE)
629	(T)	PRINTER ASSOC		11,074.00
629	(T)	COMPO FINANCIAL SER		1,918.00
231	(T)	INVESTMENT TAX CREDIT		
918		CREDIT FOR PERSONAL EXEMPTIONS		(4,000.00)
103		PENALTIES		
936		TAX MOTIVATED TRANSACTIONS		
. ADJUSTMENTS TO INCOME AND/OR DEDUCTIONS - INCREASE				8,992.00
. PLUS TAX TABLE INCOME AS SHOWN ON RETURN				38,809.00
. CORRECTED TAXABLE INCOME				47,801.00
. TAX COMPUTED WITH 4 EXEMPTIONS			TAX RATE SCHEDULE	13,700.00
. LESS TAX CREDITS: INVESTMENT TAX CREDIT				4.00
. PLUS OTHER TAXES: SELF EMPLOYMENT TAX TOTAL OTHER TAXES			1,490.00	1,490.00
. CORRECTED TAX CARRIED TO NEXT PAGE				15,186.00

17

E AND ADDRESS OF TAXPAYER:	DATE OF REPORT:
ELDON B & PHILLIS BUFFERD	SOC. SEC. NUMBER: 049-32-7803
31 OLD HOMEBEN ROAD	FORM: 1040
AIRFIELD, CT 06430	YEAR: 1979
	FILING STATUS: JOINT
ME AND TITLE OF PERSON WITH WHOM MATTERS WERE DISCUSSED:	EXAMINING DISTRICT: 008
	NAME OF EXAMINER:
	IN REPLY REFER TO: ESP:EKC

. CORRECTED TAX FROM PRECEDING PAGE	15,186.00
. LESS TAX AS SHOWN ON RETURN	2,631.00
. DEFICIENCY	12,555.00
. BALANCE DUE	12,555.00
. PENALTIES:	
NEGLIGENCE, SEC. 6653(A)(1) I.R.C.	627.75



EXPLANATION OF ADJUSTMENTS

9629 7221

It is determined, from examination of the books and records of the partnership known as Printer Associates that your share of the distributive income or losses for the taxable years shown below is $0.00 & $24.00 (respectively). Since you reported losses in the amount of ($8,950.00)& ($11,050.00),your taxable income is increased by $8,950.00 & $11,074.00 , computed as follows:

Year(s)	1978	1979
Ordinary net Income(loss) per Partnership return	($274,334.00)	($532,408.00)
Add Unallowable deductions		
1. Depreciation	$263,158.00	$526,316.00
2. Rent	$1,080.00	$1,500.00
3. Interest Expense	$0.00	$748.00
4. Amortization	$0.00	$556.00
5. All Other Deductions	$10,096.00	$4,004.00
Sub Total	$0.00	$716.00
Less: Expenses allowed to the extent of Income	$0.00	$0.00
Corrected Partnership Income (loss)	$0.00	$716.00
Your distributive share of corrected Partnership Income (loss)	$0.00	$24.00
Partnership Loss reported on your return	($8,950.00)	($11,050.00)
Increase in Income (loss)	$8,950.00	$11,074.00

EXPLANATION OF PARTNERSHIP ADJUSTMENTS

Taxable Year(s) Ending December 31, 1978, 1979

1. It is determined that the claimed losses are disallowed because the venture is a sham which lacks economic substance and should be ignored as part of a scheme designed to inflate your income tax deductions. Alternatively, it is determined that the claimed losses are disallowed because you have not established they were incurred in a trade or business, an activity engaged in for profit or with respect to property held for the production of income. Alternatively, it is determined that the depreciation claimed on the partnership return of Printer Associates is not allowable because the basis in the technology has not been established, because it has not been established that the amount of depreciation claimed bears a proper relationship to a decline in the property's usefulness, and because the non-recourse note in the amount of $4,535,000.00 lacks economic substance. Additionally, it has not been established that the partnership is entitled to any depreciation in the year 1978. Alternatively, it is determined that the amount of any non-recourse liability is too speculative and contingent to be included in any partner's basis.

2. It is determined that the investment tax credit claimed on your 1978 return and relating to the purchase rights of the M-Cell technology by Printer Associates is disallowed because it has not been established that the losses were incurred in a trade or business, an activity engaged in for profit or with respect to property held for the production of income. Alternativley, it is further determined that the credit is not allowable because it has not been established the property qualifies for the credit.

It is further determined that the following deductions are disallowed for the specific reasons stated:

1. Depreciation

a. It is determined that the deduction attributable to depreciation is disallowed since the acquired assets do not have a determinable useful life.

b. Alternatively, it is determined that the deduction attributable to depreciation is disallowed because the amount of depreciation does not bear a proper relationship to a decline in the acquired assets usefulness and, in any event, the fair market value of the M Cell technology has not been established.

c. Alternatively, it is determined that the portion of the depreciation deduction attributable to the amount of the note(s is disallowed because said note(s) lacks economic substance, and therefore, cannot be added to the cost or depreciable basis of the property.

3. Interest

a. It is determined that your claimed interest deductions are disallowed since you have not established that the amounts claimed were in fact paid or properly accrued or were deductible in the year claimed.

b. It is further determined that your claimed interest deductions are disallowed because the loan is contingent and not a present liability and because the loan transactions lack economic substance.

. All Other Deductions

a. It is determined that All Other Deductions are disallowed because you have not substantiated them or shown that they were incurred, or that they constitute ordinary and necessary business expenses. In addition, the amounts claimed are unreasonable and excessive.

b. If it is determined that these deductions were in fact incurred, such expenditures are either for syndication or are capital in nature with an indeterminate useful life and are

therefore neither currently deductible or amortizable.

ALTERNATIVE POSITION

Alternatively,if it is decided that the disallowed partnership deductions are allowable in whole or in part, then it is determined that you are only entitled to deduct your proportionatrisk", suf the partnership loss which does not exceed your amount "at Code, subject to the provisions of Section 465 of the Internal Revenue Code.

9629

It has been determined that your distributive share of the ordinary income from Compo Financial Services Ltd, partnership which has an interest in Printer Associates is $1418.00 in lieu of ($500.00) reported on your return for the taxable year ending December 31, 1979. Therefore, your income is increased by $1,918.00.

	1979
Printer Associates loss per return	($532,408.00)
add: adjustments	
Depreciation	$526,316.00
Rent	$1,500.00
Interest Expense	$748.00
Amortization	$556.00
Other deductions	$4,004.00
Corrected Ordinary Income	$716.00
Corrected distributive share of gain from Printer Assoc allocable to Compo Financial	$292.13
Losses from Printer Assoc reported by Compo Financial	($107,106.87)
Increase in income to Partnership Compo Financial	$107,399.00
Compo Financial loss per return	($102,973.00)
add: reduction of loss from Printer Assoc	$107,399.00
Corrected partnership loss for Compo Financial	$4,426.00
Compo Financial income claimed on your return	($500.00)
Your distributive share of corrected partnership income	$1,418.00
Increase in income	$1,918.00

EXPLANATION OF ADJUSTMENTS FOR PRINTER ASSOCIATES FOR THE YEAR ENDED DEC 31, 1979

Sheldon B Bufferd & Phyllis Bufferd EXPLANATION OF ADJUSTMENTS

See the above for the explanation of adjustments for Printer Associates.

The adjustments flow from Printer Associates to Compo Financial Services and from Compo Financial Services to you per section 702 of the Internal Revenue Code.

7308

It is determined that your credit allocable to targeted jobs credit is $4,974.00 in lieu of zero claimed on your 1978 tax return. Accordingly, your tax is reduced by $4,974.00.

8511

Your tax has been recomputed using the tax rate schedule for 1978, since the Schedule "G" base period taxable incomes have not been substantiated.

7221 7308

It is determined that your credits allocable to investment tax credit carryback and targeted jobs credit carryback are reduced by $3,069.00 for 1975, $3,704.00 for 1976, and $6,291.00 for 1977. Accordingly, your tax is increased by $3,069.00 for 1975, $3,704.00 for 1976, and $6,291.00 for 1977. These adjustments flow from the adjustments to your 1978 and 1979 tax returns, see above.

A duplicate original is being mailed to you at the following addresses:

1242 Old Academy Road
Fairfield, Ct. 06430

and

30 Woodpecker Ln
Whispering Pines, NC 28327

and

11 Oak Lane
Weston, Ct 06880

and

11 Oak Lane
Weston, Ct 06883

ORIGINAL

No. 91-7804

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1991

SHELDON B. BUFFERD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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- I -

QUESTION PRESENTED

Whether, when a loss and an investment tax credit are erroneously claimed on the return of a subchapter S corporation, and those items "pass through" to the return of a shareholder (with whom an extension of the period of limitation has been duly executed), they may be disallowed on the shareholder's return after the limitations period for assessing a tax against the corporation has expired.

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-5a) is reported at 952 F.2d 675. The opinion of the Tax Court (Pet. App. 6a-11a) is reported unofficially at 61 T.C.M. (CCH) 2410.

JURISDICTION

The judgment of the court of appeals was entered on January 3, 1992. The petition for a writ of certiorari was filed on March 30, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1.a. In 1979, petitioner was a shareholder of a qualified small business corporation known as Compo Financial Services,

Inc. Under the provisions of subchapter S of the Internal Revenue Code, all items of income, loss and tax credits of a qualified small business corporation "pass through" to the shareholders of the corporation and are reported on their individual income tax returns. See 26 U.S.C. 1366(a)-(c).1/ The subchapter S corporation is itelf directly liable for tax in only a few, limited circumstances not involved in this case.2/ When items "flow through" to the shareholders, it is the shareholders (rather than the corporation) whose tax is affected by disallowance of erroneous items shown on the corporate return. See ibid.

Under Section 6037 of the Code, Subchapter S corporations are required to file annual income tax returns that serve both

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1/ During the period involved in this case, the subchapter S provisions were located at 26 U.S.C. 1371, et seq. These provisons were modified and renumbered as 26 U.S.C. 1361, et seq. by the Subchapter S Revision Act of 1982, § 2, Pub. L. No. 97-354, 96 Stat. 1669. The modification and reenactment of the subchapter S provisions in 1982 did not affect the issue presented in this case. See pages 13-15, infra.

2/ During the period relevant to this suit, a subchapter S corporation was itself liable for tax only in limited circumstances. It was subject to a special tax imposed on certain of its long-term capital gains under 26 U.S.C. 1378 (1976). Such gains also could generate a "minimum tax" on the corporation under Sections 56 and 58(d)(2) as then in effect. See B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 6.06, at 6-26 to 6-28 (4th ed. 1979). Otherwise, however, so long as the corporation preserved its subchapter S status, it was exempt from the regular income tax imposed on other corporations by Section 11, and its gains, losses, and credits were apportioned to its shareholders according to their respective interests in its stock. In that respect, the "pass through" treatment afforded a subchapter S corporation and its shareholders resembles the treatment historically afforded to a partnership and its partners. See United States v. Basye, 410 U.S. 441, 448 n. 8 (1973).

(i) as "information returns," providing detailed information on income and deductions for the preparation of individual shareholder returns and (ii) as corporate returns in the limited situations when the corporation is itself liable for tax (see note 2, supra). See Fehlhaber v. Commissioner, 954 F.2d 653, 655 (11th Cir. 1992). Pursuant to Section 6037, the subchapter S corporation of which petitioner was a shareholder reported an erroneous loss deduction and tax credit for 1979 that "passed through" to petitioner's individual income tax return for that year (Pet. App. 2a, 8a-9a).

b. Section 6501(a) of the Internal Revenue Code generally requires that any assessment of income taxes be made by the Internal Revenue Service "within 3 years after the return was filed." 26 U.S.C. 6501(a).3/ This three-year limitations period may be extended by a written agreement signed by the IRS and the taxpayer before the period expires, 26 U.S.C. 6501(c)(4). If the Internal Revenue Service mails a notice of deficiency to a taxpayer while the assessment period is still open (by virtue of such an extension or otherwise), and if the

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3/ 26 U.S.C. 6501(a) provides:

> Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

taxpayer timely seeks review of the deficiency in the Tax Court, the assessment period stays open until after the Tax Court's decision becomes final. 26 U.S.C. 6503(a)(1).

In March 1983, before the three-year period for assessing petitioner's 1979 taxes expired, petitioner and the Internal Revenue Service signed a consent to extend the period in accordance with Section 6501(c)(4). In December 1987, within the period so extended, the Service mailed petitioner a notice of deficiency. The notice asserted a deficiency in petitioner's income tax for 1979 based upon the disallowance of his distributive share of the erroneous loss deduction and tax credit reported by Compo.4/

Petitioner filed a timely Tax Court petition for review of the deficiency (Pet App. 2a, 9a-10a). While not disputing that the assessment period applicable to his individual tax return remained open due to his extension agreement and petition to the Tax Court (Pet. App. 5a), petitioner claimed that disallowance on his return of the "pass through" items from the subchapter S corporation was time-barred because the period for assessing a tax against that corporation had lapsed.

Petitioner's contention was based upon Section 6037(a) of the Code, which indicates that the statute of limitations for a return filed by a subchapter S corporation is the same as for a

---

4/ The deficiency also resulted in part from disallowance of a separate loss deduction that petitioner claimed from his investment in a partnership. That adjustment was resolved before the Tax Court issued its opinion in this case (Pet. App. 8a).

return filed by a normal business corporation under Section 6012 of the Code. See 26 U.S.C. 6037(a). The 1979 return of Compo Financial was filed on or before February 15, 1980 (Pet. App. 9a). Because the adjustments to the erroneous deduction and tax credit that "passed through" to petitioner in this case did not create any tax liability for the subchapter S corporation, and since that corporation was not liable for petitioner's tax deficiencies resulting from inclusion of the erroneous subchapter S corporation deductions and tax credits, the Service did not seek an extension of the limitations period for assessing taxes against the corporation for 1979. The three-year period for making an assessment against the corporation for taxes it owed under its 1979 return thus expired on February 15, 1983, before the IRS mailed a notice of deficiency to petitioner.

2. The Tax Court concluded that the period for assessing the deficiency in petitioner's taxes had not expired (Pet. App. 6a-11a). The court held that the period during which taxes may be assessed under Section 6501 "is measured with reference to the individual shareholder's income tax return, rather than the [subchapter S] corporation's information return" (id. at 10a). In so ruling, the court followed its unanimous, reviewed decision in Fehlhaber v. Commissioner, 94 T.C. 863 (1990), aff'd, 954 F.2d 653 (11th Cir. 1992). The Tax Court acknowledged that its decisions in Fehlhaber and in this case were in conflict with Kelley v. Commissioner, 877 F.2d 756 (1989), where the Ninth Circuit held that "pass through" items from a subchapter S

corporation could not be disallowed on the return of an individual shareholder after the time for assessing a tax against the corporation had expired. The Tax Court concluded that Kelley was wrongly decided and declined to apply it in cases not appealable to the Ninth Circuit (Pet. App. 11a).

3. The Second Circuit affirmed (Pet. App. 1a-5a). The court of appeals concluded that, under the "clear and unambiguous" language of the statute, "the relevant return for purposes of section 6501(a) is [petitioner's] return rather than Compo's S corporation return" (Pet. App. 4a, 5a). In the court's view, Sections 6037 and 6051 created no impediment to assessing petitioner for his personal tax deficiency produced by adjustments to his share of "pass through" items derived from the subchapter S corporation's return. The court explained that "[a]n adjustment to the return of an S corporation that does not impose tax liability on that S corporation is not barred by sections 6501(a) and 6037" (id. at 4a). For this reason, the court of appeals expressly "disagree[d]" with the contrary decision of the Ninth Circuit in Kelley (id. at 4a).

DISCUSSION

The court of appeals correctly held that expiration of the period for assessing taxes against a subchapter S corporation does not bar the Internal Revenue Service from disallowing erroneous corporate deductions and credits that "flow through" to the individual shareholders' returns. Petitioner is correct, however, in noting (Pet. 5-9) that this case involves a recurring

question of substantial importance that has produced conflicting decisions among the circuits. We therefore do not oppose the granting of certiorari.

1. Section 6501(a) of the Internal Revenue Code provides that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed." 26 U.S.C. 6501(a).5/ Under the plain language of this statute, an assessment is not barred unless it is made more than three years after the filing of "the return" of the taxpayer against whom the tax is assessed. Since the taxes resulting from the income and deductions that "flow through" to the shareholder of a subchapter S corporation are owed by the shareholder, and not by the corporation, the period for assessing the shareholder's taxes runs from the filing of his return. Before that period expired in this case, petitioner agreed to extend it in accordance with Section 6501(c)(4) of the Code (Pet. App. 5a). The notice of deficiency was mailed to petitioner within the period so extended and, therefore, within the time allowed by the statute.

It is irrelevant that the three-year period for assessing taxes that might, in some other situation (see note 2, supra), be owed by the subchapter S corporation had expired before the deficiency notice was issued to petitioner. The subchapter S corporation is not itself liable for taxes on the income and

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5/ Because a statute of limitations is invoked to bar the collection of taxes otherwise lawfully due, its terms are to be construed narrowly in favor of the government. See Badaracco v. Commissioner, 464 U.S. 386, 391-392 (1984).

deductions that "pass through" to its shareholders; only the shareholders are liable for taxes on these items. Moreover, the income tax return of the subchapter S corporation obviously does not contain sufficient information to compute the shareholders' tax liabilities, which depend not only on the "pass through" items from the subchapter S corporation but also on income, deductions, and exemptions received from other sources. See Siben v. Commissioner, 930 F.2d 1034, 1036 (2d Cir. 1991), cert. denied, 112 S.Ct. 429 (1991).

The court of appeals correctly rejected petitioner's contention (Pet. 7) that Section 6037 of the Code requires a different conclusion. Under Section 6037, a subchapter S corporation is required to file an information return each year and is to report its tax liability in the limited situations when it is directly liable for tax (Pet. App. 4a; see note 2, supra). In those limited circumstances, the period for assessing a tax directly against the subchapter S corporation runs from the date that its return is filed. Because the erroneous losses and credits claimed by the subchapter S corporation "pass through" to its shareholders, however, it is the shareholders -- not the subchapter S corporation -- who are liable for taxes resulting from disallowance of the erroneous items. It is thus from the date that the shareholders' returns are filed -- not the date that the corporation's return was filed -- that the limitations period for assessment runs under Section 6501(a). See Pet. App. 4a.

2. We agree with petitioner (Pet. 5), however, that Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989), squarely conflicts with the decision in this case. In Kelly, the Internal Revenue Service asserted an income tax deficiency against a shareholder of a subchapter S corporation with respect to the disallowance of a deduction that "passed through" to the shareholder from the corporation. The Ninth Circuit held that the time for assessing the individual shareholder's tax liability ran from the filing of the return of the subchapter S corporation and that the notice of deficiency issued to the shareholder in that case was therefore untimely. The reasoning of the court in Kelley was (i) that, under Section 6037, any assessment against a subchapter S corporation for taxes it might owe directly is barred three years after the corporate return is filed and (ii) that, since a subchapter S corporation may discard its books and records following expiration of the three-year period for assessing any taxes against it directly, the shareholders would be left with no way to document "flow-through" items claimed on their personal returns. 877 F.2d at 758-759.6/

6/ The Ninth Circuit followed Kelley in Holmes v. Director of the Dept. of Rev. & Taxation, 937 F.2d 481 (1991), which concerned the analogous question of the timeliness of an assessment against a shareholder in a subchapter S corporation under the revenue laws of Guam, which mirror the Internal Revenue Code. Similarly, in Fendell v. Commissioner, 906 F.2d 362 (8th Cir. 1990), the Eight Circuit held that the income tax liability of a trust beneficiary for items of income that were distributed to the beneficiary from a trust could not be assessed after the limitations period for assessing taxes directly against the trust had expired.

In this case, however, the Tax Court and the Second Circuit specifically "disagree[d]" with the reasoning and result of Kelley (Pet. App. 4a, 10a-11a). The court of appeals correctly concluded in this case that the provisions of Section 6037 -- which concern the limitations period that applies when a subchapter S corporation is directly liable for a tax (see note 2, supra) -- have no bearing on the limitations period under Section 6501(a) for the assessment of tax for items of income that "pass through" to the individual shareholders of the corporation under 26 U.S.C. 1366(a)-(c). The court of appeals also correctly disagreed with the unsupported assumption in Kelley that shareholders lack proper access to corporate records needed to support "pass through" items of subchapter S income reported on their returns (Pet. App. 4).

The recent decision of the Eleventh Circuit in Fehlhaber v. Commissioner, 954 F.2d 653 (1992), also conflicts with the Ninth Circuit's decision in Kelley. In Fehlhaber, the IRS disallowed a shareholder's claim to a distributive loss from a subchapter S corporation and asserted an income tax deficiency against the shareholder on that basis. The deficiency notice was issued to the shareholder less than three years after he filed his personal return but more than three years after the filing of the return of the subchapter S corporation. Id. at 654-655. The Eleventh Circuit held that the assessment in that case was timely; in so holding, the court acknowledged that its decision was "in conflict with the Ninth Circuit's opinion in Kelley" (id. at

657).7/ See also Siben v. Commissioner, 930 F.2d at 1037 (period for assessing taxes owed by a partner based upon adjustments to "pass through" partnership items runs from the date of the partner's personal return, not from the date of the partnership return).

3.a. The conflict created by Kelley, Fehlhaber, and the decision in this case concerns a recurring matter of considerable administrative importance. Subchapter S corporations are often used for distributing deductions and tax credits to investors for application against their income from other sources. When the Internal Revenue Service proposes to audit or make adjustments to an individual shareholder's personal return on account of such "pass through" items, the Service frequently seeks the shareholder's consent to extend the time for assessing his taxes without obtaining extensions from the subchapter S corporation.

Such extensions of the limitations period have a significant and productive role in the process of determining taxes because they facilitate review and compromise of tax disputes before a formal notice of deficiency is issued. Under the decision of the Ninth Circuit in Kelley, however, the Service apparently would be required to proceed directly (even if precipitously) against the shareholder in circumstances where an effective consent to extension cannot be secured.

7/ A similar question as to the timeliness of an income tax deficiency asserted against a shareholder in a subchapter S corporation is pending before the Fifth Circuit in Green v. Commissioner, No. 90-4629.

The Service advises us that a survey of cases currently under audit, involving shareholders of approximately 2,000 subchapter S corporations, has identified approximately $100 million of revenue that may be jeopardized if the period for assessing the shareholders were deemed coterminous with that applicable to the corporations. This same issue would be expected to recur frequently in future audit periods.

b. The prospective impact of the question presented in this case is not materially reduced by Section 4(a) of the Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669, which added Sections 6241 through 6245 to the Internal Revenue Code for tax years after 1982. Under these new provisions, the unified audit and litigation procedures applicable to partnerships (see 26 U.S.C. 6221 et seq., as enacted by the Tax Treatment of Partnership Items Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 648) are extended to subchapter S corporations for tax years beginning in 1983. The objective of these provisons is to provide unified treatment of subchapter S items at the corporate level, rather than examining each shareholder's return separately. See Fehlhaber v. Commissioner, 954 F.2d at 657. The new provisons thus generally specify that the period for assessing a shareholder's tax attributable to a subchapter S "pass through" item begins on the date on which the corporation's return was filed. See 26 U.S.C. 6229(a), 6244 (1982). Congress recognized, however, that this represents a departure from the prior law, under which "[t]he filing by the corporation of its

return does not affect the statute of limitations applicable to the shareholders." S.Rep. No. 97-640, 97th Cong., 2d Sess. 25 (1982).

Notwithstanding the apparently broad scope of these new, unified audit provisions, the question presented in this case remains of substantial, continuing importance. Under regulations authorized by Congress as part of the 1982 legislation (see 26 U.S.C. 6341), the Service has specified that the unified audit procedures of the Act are not applicable to subchapter S corporations that have five or fewer shareholders. See Temp. Reg. § 301.6241-1T(c)(2)(i) (1987).8/ The Service advises us that the vast majority of subchapter S corporations (perhaps as many as 95%) have five or fewer shareholders and therefore fall within the excepted category of the regulations. The question presented in this case, and its recurring administrative

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8/ The temporary regulation is effective for subchapter S corporations whose returns are due on or after January 30, 1987. See Eastern States Casualty Agency, Inc. v. Commissioner, 96 T.C. 773, 781 (1991). The regulation was adopted as a counterpart to the statutory exception from the unified audit procedures for "small" partnerships that have ten or fewer partners (26 U.S.C. 6231(a)(1)).

For the period prior to the effective date of the temporary regulation, the definition of a "small" S corporation under the 1982 Act is unsettled. Compare Arenjay v. Commissioner, 920 F.2d 269 (5th Cir. 1991) (S corporation with ten or fewer shareholders is exempt from the unified audit procedures of the 1982 Act), with Eastern States Casualty Agency, Inc. v. Commissioner, 96 T.C. at 774-783 (between 1982 and the effective date of the temporary regulation, all S corporations, even those with only one shareholder, are subject to the unified audit procedures of the 1982 Act).

importance, thus remain largely unaffected by the new unified audit procedures available under the Code.

In the absence of a decision from this Court, the statute of limitations for the assessment of taxes owed by shareholders for items of "pass through" income and deductions from a subchapter S corporation will vary depending solely upon the circuit in which the issue is presented. Resolution of this recurring issue by this Court is needed to avoid continuing uncertainty and inconsistent application of the revenue laws.

CONCLUSION

Respondent does not oppose the granting of the petition for a writ of certiorari.

Respectfully submitted.

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MAY 1992

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SHELDON B. BUFFERD,

Petitioner,

vs.

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Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

JOINT APPENDIX

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Petition For Certiorari Filed March 31, 1992
Certiorari Granted June 22, 1992

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Relevant Docket Entries

February 29, 1988	Petition filed.
April 22, 1988	Answer filed.
September 27, 1988	Amendment to petition filed.
October 13, 1988	Answer to Amended petition filed.
March 6, 1989	Hearing before Judge Clapp
May 22, 1989	Stipulation of settled issues filed.
March 19, 1990	Trial
April 15, 1991	Memorandum Opinion by Judge Whitaker
May 20, 1991	Notice of appeal filed.

UNITED STATES TAX COURT

SHELDON B. BUFFERD & PHYLLIS BUFFERD Petitioners v COMMISSIONER OF INTERNAL REVENUE Respondent	Docket No. 3970-88

PETITION

Sheldon B. Bufferd & Phyllis Bufferd ("Petitioners"), disagree with the tax deficiencies, as set forth in the Notices of Deficiency, dated December 4, 1987, issued by the Office of the Internal Revenue at Portsmith, New Hampshire.

Petitioners' Taxpayer Identification Number is 049-32-7803.

The deficiencies as determined by the Commissioner, are in income taxes for the years 1975,1976,1977,1978 and 1979. The deficiency asserted for 1975 is $ 3,069.00; The deficiency asserted for 1976 is $ 3,704.00; The deficiency asserted for 1977 is $ 6,291.00; The deficiency asserted for 1978 is $ 13,359.00; The deficiency asserted for 1979 is $12,555.00. In addition, penalties under Internal Revenue Code Sections 6653(a)(1) and 6659 are also asserted. Petitioners dispute all amounts asserted for each year, and as the basis for their case, allege as follows:

That the determinations set forth in said notices of deficiency, are based on the following errors:

1. The Commissioner erred in determining that the Petitioners did not realize their claimed loss(es) arising from deductions attributable to Printer Associates (the "Partnership").

2. The Commissioner erred, with respect to the loss referred to above, in determining that:

   a. The venture was a sham which lacked economic substance and should be ignored as part of a scheme designed to inflate income tax deductions.

   b. The activities were not incurred by a trade or business, or engaged in for profit, or with respect to property held for the production of income.

   c. Alternatively, the Partnership's depreciation deduction was not allowable because:

      1. The basis of the Technology had not been established.

      2. The amount did not bear a proper relationship to a decline in the property's usefulness.

      3. The Purchase Note lacked economic substance.

      4. There was no entitlement to the deduction.

      5. The amount of non-recourse liability was too speculative, and contingent to be included in any Partner's basis.

3. The Commissioner erred, with respect to the investment tax credit claimed, relating to the purchase of the M-Cell Technology (the "Technology") by the Partnership, in determining that:

a. The Partnership was not engaged in a trade or business, or entered into for profit, or with respect to property held for production of income.

b. The Technology did not qualify for the credit.

4. The Commissioner erred, with respect to the Partnership's depreciation deduction, in determining that:

a. The acquired assets did not have a determinable life.

b. The amount did not bear a proper relationship to a decline in the assets' usefulness, and that the fair market value had not been established.

c. The portion attributable to the amount of the Note(s) was not allowable because the Note(s) lacked economic substance.

5. The Commissioner erred, with respect to the Partnership's interest deduction, in determining that:

a. The amounts claimed were not established as having been paid, or properly accrued, or were deductible in the year claimed.

b. The interest was not deductible because the loan was contingent, not a present

liability, and because the loan transactions lacked economic substance.

6. The Commissioner erred, with respect to all other deductions of the Partnership, in determining that:

a. All other deductions were not substantiated, shown to have been incurred, or that they were ordinary and necessary business expenses.

b. They were unreasonable and excessive.

c. They were either for syndication, or capital in nature with an indeterminable useful life.

7. The Commissioner erred, with respect to the distributive share of income (loss) from Compo Financial Services, Ltd. ("CFS"), in determining that:

a. The Petitioners did not realize their claimed loss(es) arising from deductions atributable to CFS.

b. The Petitioners were not entitled to any tax credits arising from transactions attributable to CFS.

c. CFS is a partnership.

d. CFS has a fiscal year ending December 31st.

8. The Commissioner erred in determining that the deficiency was due to negligence or intentional disregard of the rules and regulations.

9. The Commissioner erred in determining that Petitioners had substantial underpayment of tax

attributable to tax motivated transactions and valuation overstatement.

The facts upon which the Petitioners rely, as the basis for the Petitioners' case, are as follows:

1. Petitioners invested in the Partnership which was formed, entered into, operated and conducted for the purpose of making a profit from the exploitation of the principal asset of the Partnership, which consisted of ten computer source tapes together with other personal property (the "Technology").

2. The events and transactions giving rise to the loss actually occurred, and their substance conformed to the forms in which they they were structured.

3. Substantial, documented efforts to exploit the Technology have been made over the years.

4. The Technology is tangible personal property with a determinable useful life, and, therefore, was both depreciable and eligible for the investment tax credit.

5. The purchase price of the Technology was its fair market value on the date of acquisition by the Partnership, based upon independent appraisal.

6. The depreciation claimed bears proper relationship to a decline in the property's usefulness, and was allowable under the half-year depreciation convention.

7. The Partnership's basis in the Technology included recourse notes by it to the seller, which, accordingly, are included in the Partners'

basis for depreciation and investment tax purposes.

8. All other deductions of the Partnership were ordinary and necessary business expenses under Internal Revenue Code Section 162, were reasonable in amount, and were actually incurred.

9. Petitioners invested in CFS, a Connecticut corporation having a fiscal year ending November 30th, which had elected to be treated as an "electing small business corporation" for income tax purposes, under Section 1872(a) of the Internal Revenue Code.

10. CFS purchased investment units in the Partnership, and realized the losses and credits it claimed, which flowed from the Partnership per Section 702 of the internal Revenue Code, for the same reasons as stated above in Petitioners' statements of facts relating to their direct investment in the Partnership.

11. Section 702 of the Internal Revenue Code does not apply to corporations, or their shareholders.

12. To the best of our knowledge and belief, no Special Consent to to Extend the Period of Time to Assess Tax had been granted by CFS for its year ending November 30, 1979. Accordingly, the statute of limitations would have expired with respect to any changes in the CFS net income for such year.

Wherefore, Petitioners pray that the Court determine that there are no deficiencies in income tax.

Dated: February 25, 1988

/s/ Sheldon B. Bufferd
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1242 Old Academy Road
Fairfield, Connecticut 06430

/s/ Phyllis Bufferd
Phyllis Bufferd, Petitioner
13 Hale Street
Westport, Connecticut 06880

Illegible

UNITED STATES TAX COURT

Docket No. 3970-88

(Caption Omitted In Printing)

ANSWER

THE RESPONDENT, in answer to the petition filed in this case, admits, denies and alleges as follows:

1. FIRST UNNUMBERED and UNLETTERED PARAGRAPH. Admits that the notice of deficiency, dated December 4, 1987, was issued by the Office of the Internal Revenue Service at Portsmouth, New Hampshire.

2. SECOND UNNUMBERED and UNLETTERED PARAGRAPH. Admits.

3. THIRD UNNUMBERED and UNLETTERED PARAGRAPH. Admits.

4. FOURTH UNNUMBERED and UNLETTERED PARAGRAPH (1) through (9). Denies that respondent erred as alleged in the FOURTH UNNUMBERED and UNLETTERED PARAGRAPH (1) through (9) and all sub-paragraphs thereunder.

5. FIFTH UNNUMBERED and UNLETTERED PARAGRAPH (1) through (11). Denies.

5. FIFTH UNNUMBERED and UNLETTERED PARAGRAPH (12). Denies for lack of present knowledge or information.

6. Denies generally each and every allegation of the petition not heretofore specifically admitted, qualified ordenied [sic].

WHEREFORE, it is prayed that the deficiencies and additions to tax determined by the respondent be in all respects approved.

WILLIAM F. NELSON
Chief Counsel
Date: Apr 21 1988 Internal Revenue Service

OF COUNSEL:
AGATHA L. VORSANGER
Regional counsel

By: /s/ (signed) Michael P. Breton
MICHAEL P. BRETON
Attorney

By: /s/ Powell W. Holly, Jr.
POWELL W. HOLLY, JR.
District Counsel
Internal Revenue Service
135 High Street, Rm. 259
Hartford, CT 06103
Tel. No. (203) 240-4253
(FTS) 244-4253

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing paper was served on Sheldon B. Bufferd by mailing the same on in a postage-paid wrapper addressed to him at 1242 Old Academy Road, Fairfield, Connecticut 06430 and to Phyllis Bufferd, by mailing the same on Apr 21 1988 in a postage-paid wrapper addressed to her at 13 Hale Street, Westport, Connecticut o60880 and a copy thereof was

mailed to the Tax Court by Express Mail, Receipt No. B 93984393, on Apr 21 1988

Dated: Illegible

/s/ (Signed) Michael P. Breton
MICHAEL P. BRETON
Attorney

UNITED STATES TAX COURT

Docket No. 3970-88

(Caption Omitted In Printing)

STIPULATION OF FACTS

In accordance with Tax Court Rule 91(a), the below-signed parties agree to this STIPULATION OF FACTS pursuant to the general terms of this preamble, unless specifically expressed otherwise. all stipulated facts shall be conclusive. All stipulated exhibits shall be considered authentic. All copies shall be considered electronic reproductions of the originals and shall be treated as originals. The truth of assertions within stipulated exhibits may be rebutted or corroborated by additional evidence. Any relevancy objections may be made with respect to all or any part of the stipulation at the time of submission.

1. The petitioners reported their income and deductions for the taxable year 1979 on the basis of cash receipts and disbursements.

2. The petitioners filed their federal income tax return for the taxable year 1979 (hereinafter, "the 1979 return") on April 15, 1980. A copy of the 1979 return is attached hereto and marked as Joint Exhibit 1-A.

3. The petitioner, Sheldon B. Bufferd, resided at 1242 Old Academy Road, Fairfield, Connecticut, at the time the petitioners filed their petition herein.

4. The petitioner, Phyllis Bufferd, resided at 13 Hale Street, Westport, Connecticut, at the time the petitioners filed their petition herein.

5. The petitioner, Phyllis Bufferd, is not liable for any deficiencies for the taxable years 1975, 1976, 1977, 1978 or 1979 by reason of the provisions of I.R.C. § 6013(e).

6. The petitioner, Phyllis Bufferd, is not liable for an addition to the tax for the taxable years 1975, 1976, 1977, 1978 or 1979 under the provisions of I.R.C. § 6653(a) by reason of the provisions of I.R.C. § 6013(e).

7. The petitioner, Phyllis Bufferd, is not liable for an addition to the tax for the taxable years 1975, 1976, 1977, 1978 or 1979 under the provisions of I.R.C. § 6659 by reason of the provisions of I.R.C. § 6013(e).

8. The petitioner, Phyllis Bufferd, is not liable for the increased rate of interest under I.R.C. § 6621(c) for the taxable years 1975, 1976, 1977, 1978 or 1979 by reason of the provisions of I.R.C. § 6013(e).

9. In 1979, Sheldon B. Bufferd (hereinafter, "the petitioner"), was a shareholder in Compo Financial Services, Ltd. (hereinafter, "Compo").

10. In 1979, Compo was an electing small business corporation within the meaning of I.R.C. § 1371(a). A copy of Election by a Small Business Corporation (Form 2553) filed by Compo on January 2, 1979 is attached hereto and marked as Joint Exhibit 2-B.

11. Compo timely filed a U.S. Small Business Corporation Income Tax Return (Form 1120"S") for the taxable period December 26, 1978 through November 30, 1979 on February 1, 1990. A copy of said return is attached hereto and marked as Joint Exhibit 3-C.

12. Compo did not extend the statute of limitations for assessment of taxes as provided under the provisions of I.R.C. § 6501(c)(4) with respect to its taxable period ended November 30, 1979.

13. On December 21, 1983, the petitioner, in his capacity as Secretary/Treasurer of Compo. executed a Special Consent to Extend the Time to Assess Tax (hereinafter, "Form 872-A") with respect to the taxable period ended November 30, 1980. A copy of said Form 872-A is attached hereto and marked as Joint Exhibit 4-D.

14. On December 15, 1987, the respondent executed a Notice of Termination of Special Consent to Extend the Time to Assess Tax (hereinafter, "Form 872-T") with respect to a Form 872-A dated July 22, 1985, executed by the parties with respect to Compo's taxable period ended November 30, 1982. A copy of said form 872-T is attached hereto and marked as Joint Exhibit 5-E.

15. The petitioner is entitled to an ordinary deduction in the amount of $20,000.00 for the taxable year 1978, said deduction being equal to his cash investment in Printer Associates.

16. The petitioner is not entitled to any other losses or credits attributable to Printer Associates for any year except as provided in paragraph 15., above.

17. On their 1979 return, the petitioners claimed an ordinary loss with respect to two entities in the total amount of $11,550.00, summarized as follows:

Printer Associates	$11,050.00
Compo Financial Services, Inc.	$ 500.00

18. On the 1979 return, the petitioners claimed an investment credit with respect to Compo in the amount of $8,023.00.

19. On March 7, 1983 the petitioners timely executed a form 872-A for their taxable year 1979. Respondent executed said Form 872-A on March 15, 1983. A copy of said Form 872-A is attached hereto and marked as Joint Exhibit 6-F.

20. Neither the petitioners nor the respondent filed a Form 872-T with respect to the petitioners' taxable year 1979.

21. By notice of deficiency dated December 4, 1987, the respondent disallowed, *inter alia*, the petitioners' claimed 1979 loss and investment credit attributable to Compo for its taxable period December 26, 1978 through November 30, 1979. The respondent further determined that the petitioner's distributive share of Compo income in 1979 was $1,418.00, resulting in a total adjustment with respect to Compo in the amount of $1,918.00. A copy of said notice of deficiency is attached hereto and marked as Joint Exhibit 7-G.

22. The statutory notice of deficiency dated December 4, 1987, was timely sent to the petitioners prior to the expiration of the three-year period for assessment with respect to the petitioners' 1979 return, as duly and timely extended under the agreement referred to in paragraph 19., above.

24. The statutory notice of deficiency dated December 4, 1987, was issued to the petitioners more than three years after the filing of Compo's Form 1120"S" for the

taxable period ended November 30, 1979, for which an extension of the assessment period was not executed by the corporation.

ABRAHAM N. M. SHASHY, JR.
Chief Counsel
Internal REvenue Service

SHELDON B. BUFFERD
Petitioner
P.O. Box 547
Westport, CT 06881

PHYLLIS BUFFERD
Petitioner
109 North Argyle Avenue
Margate, New Jersey 08402

By: _____
BRADFORD A. JOHNSON
Assistant District Counsel
Tax Court No. JB0034
135 High Street, Rm. 259
Hartford, CT 06103
Tel. No. (203) 240-4253
FTS 244-4253
Dated:

Dated:

UNITED STATES TAX COURT

Docket No. 3970-88
(Caption Omitted in Printing)

SECOND STIPULATION OF FACTS

In accordance with Tax Court Rule 91(a), the below-signed parties agree to this SECOND STIPULATION OF FACTS pursuant to the general terms of this preamble, unless specifically expressed otherwise. All stipulated facts shall be conclusive. All stipulated exhibits shall be considered electronic reproductions of the originals and shall be treated as originals. The truth of assertions within stipulated exhibits may be rebutted or corroborated by additional evidence. Any relevancy objections may be made with respect to all or any part of the stipulation at the time of submission.

25. Sheldon B. Bufferd (hereinafter, the "petitioner is not liable for an addition to the tax for the taxable years 1975, 1976, 1977, 1978 or 1979 under the provisions of I.R.C. § 6653(a).

26. The petitioner is not liable for an addition to the tax for the taxable years 1975, 1976, 1977, 1978 or 1979 under the provisions of I.R.C. § 6659.

27. The petitioner is liable for the increased rate of interest under I.R.C. § 6621(c) for the taxable years 1975, 1976, 1977, 1978 and 1979.

ABRAHAM N. M. SHASHY, JR.
Chief Counsel
Internal Revenue Service

SHELDON B. BUFFERD
Petitioner
P.O. Box 547
Westport, CT 06881

PHYLLIS BUFFERD
Petitioner
109 North Argyle Avenue
Margate, New Jersey 08402

By: _____
BRADFORD A. JOHNSON
Assistant District Counsel
Tax Court No. JB0034
135 High Street, Rm. 259
Hartford, CT 06103
Tel. No. (203) 240-4253
(FTS) 244-4253

Dated:

Dated:

EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

Tax Computation (See instructions on page 12)	32 Amount from line 31 (adjusted gross income)			32	48,164
	33 If you do not itemize deductions, enter zero If you itemize, complete Schedule A (Form 1040) and enter amount from Schedule A, line 41 **Caution:** If you have unearned income and can be claimed as a dependent on your parent's return, check here ▶ ☐ and see page 12 of the instructions. Also see page 12 of the instructions if: ● You are married filing a separate return & your spouse itemizes deductions, OR ● You file Form 4563, OR ● You are a dual-status alien			33	9,355
	34 Subtract line 33 from line 32. Use the amount on line 34 to find your tax from the Tax Tables, or to figure your tax on Schedule TC, Part I Use Schedule TC, Part I, and the Tax Rate Schedules ONLY if: ● Line 34 is more than $20,000 ($40,000 if you checked Filing Status Box 2 or 5), OR ● You have more exemptions than covered in the Tax Table for your filing status, OR ● You use Schedule G or Form 4726 to figure your tax Otherwise, you MUST use the Tax Tables to find your tax.			34	38,609
	35 Tax. Enter tax here & check if from ☒ Tax tables or ☐ Schedule TC			35	8,023
	36 Additional taxes. (See page 12 of instructions) Enter total and check if from ☐ Form 4970, ☐ Form 4972 ☐ Form 5544 ☐ Form 5405, or ☐ Section 72(m)(5) penalty tax			36	
	37 Total. Add lines 35 and 36 ▶			37	8,023
Credits	38 Credit for contributions to candidates for public office	38			
	39 Credit for the elderly (attach Schedules R&RP)	39			
	40 Credit for child & dependent care expenses (attach Form 2441)	40			
	41 Investment credit (attach Form 3468)	41	8,023		
	42 Foreign tax credit (attach Form 1116)	42			
	43 Work Incentive (WIN) Credit (attach Form 4874)	43			
	44 Jobs credit (attach Form 5884)	44			
	45 Residential energy credits (attach Form 5695)	45			
	46 Total credits. Add lines 38 through 45			46	8,023
	47 **Balance.** Subtract line 46 from line 37 and enter difference (but not less than zero) ▶			47	NONE
Other Taxes (Including Advance EIC Payments)	48 Self-employment tax (attach Schedule SE)			48	1,490
	49a Minimum tax. Attach Form 4625 and check here ▶ ☐			49a	
	49b Alternative minimum tax. Attach Form 6251 and check here ▶ ☒			49b	1,141
	50 Tax from recomputing prior-year investment credit (attach Form 4255)			50	
	51a Social security (FICA) tax on tip income not reported to employer (attach Form 4137)			51a	
	51b Uncollected employee FICA and RRTA tax on tips (from Form W-2)			51b	
	52 Tax on an IRA (attach Form 5329)			52	
	53 Advance earned income credit payments received (from Form W-2)			53	
	54 **Total.** Add lines 47 through 53 ▶			54	2,631
Payments Attach Forms W-2, W-2G, and W-2P to front.	55 Total Federal income tax withheld	55			
	56 1979 estimated tax payments & credit from 1978 return	56			
	57 Earned income credit. If line 32 is under $10,000, see page 2 of Instructions	57			
	58 Amount paid with Form 4868	58			
	59 Excess FICA and RRTA tax withheld (two or more employers)	59			
	60 Credit for Federal tax on special fuels & oils (attach Form 4136 or 4136-T)	60			
	61 Regulated Investment Company credit (attach Form 2439)	61			
	62 **Total.** Add lines 55 through 61 ▶			62	NONE
Refund or Balance Due	63 If line 62 is larger than line 54, enter amount **OVERPAID** ▶			63	
	64 Amount of line 63 to be **REFUNDED TO YOU** ▶			64	
	65 Amount of line 63 to be credited on 1980 estimated tax ▶	65			
	66 If line 54 is larger than line 62, enter **BALANCE DUE.** Attach check or money order for full amount payable to "Internal Revenue Service." Write your social security number on check or money order ▶			66	2,631
	(Check ▶ ☒ if Form 2210 (2210F) is attached. See page 15 of instructions) $ 61				

PLEASE SIGN HERE

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Sheldon B Buffard 4/15/80
Your signature Date

▶ Phyllis Buffard
Spouse's signature (if filing jointly, BOTH must sign even if only one had income)

Paid Preparer's Information

Preparer's signature ▶ and date | Check if self-employed ▶ ☐ | Preparer's social security no.

Firm's name (or your's if self-employed) ▶ and address | E.I. No. ▶ | ZIP code ▶

CFP104

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Tax Computation (See instructions on page 12)	32 Amount from line 31 (adjusted gross income)			32	48,164
	33 If you do not itemize deductions, enter zero If you itemize, complete Schedule A (Form 1040) and enter amount from Schedule A, line 41 **Caution:** If you have unearned income and can be claimed as a dependent on your parent's return, check here ▶ ☐ and see page 12 of the instructions. Also see page 12 of the instructions if: ● You are married filing a separate return & your spouse itemizes deductions, OR ● You file Form 4563, OR ● You are a dual-status alien			33	9,355
	34 Subtract line 33 from line 32. Use the amount on line 34 to find your tax from the Tax Tables, or to figure your tax on Schedule TC, Part I Use Schedule TC, Part I, and the Tax Rate Schedules ONLY if: ● Line 34 is more than $20,000 ($40,000 if you checked Filing Status Box 2 or 5), OR ● You have more exemptions than covered in the Tax Table for your filing status, OR ● You use Schedule G or Form 4726 to figure your tax Otherwise, you MUST use the Tax Tables to find your tax.			34	38,809
	35 Tax. Enter tax here & check if from ☒ Tax tables or ☐ Schedule TC			35	8,023
	36 Additional taxes. (See page 12 of instructions) Enter total and check if from ☐ Form 4970, ☐ Form 4972 ☐ Form 5544 ☐ Form 5405, or ☐ Section 72(m)(5) penalty tax			36	
	37 Total. Add lines 35 and 36 ▶			37	8,023
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	45 Residential energy credits (attach Form 5695)	45			
	46 Total credits. Add lines 38 through 45			46	8,023
	47 Balance. Subtract line 46 from line 37 and enter difference (but not less than zero) ▶			47	NONE
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	49a Minimum tax. Attach Form 4625 and check here ▶ ☐			49a	
	49b Alternative minimum tax. Attach Form 6251 and check here ▶ ☒			49b	1,141
	50 Tax from recomputing prior-year investment credit (attach Form 4255)			50	
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	51b Uncollected employee FICA and RRTA tax on tips (from Form W-2)			51b	
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	53 Advance earned income credit payments received (from Form W-2)			53	
	54 Total. Add lines 47 through 53 ▶			54	2,631
Payments Attach Forms W-2, W-2G, and W-2P to front.	55 Total Federal income tax withheld	55			
	56 1979 estimated tax payments & credit from 1978 return	56			
	57 Earned income credit. If line 32 is under $10,000, see page 2 of Instructions	57			
	58 Amount paid with Form 4868	58			
	59 Excess FICA and RRTA tax withheld (two or more employers)	59			
	60 Credit for Federal tax on special fuels & oils (attach Form 4136 or 4136-T)	60			
	61 Regulated Investment Company credit (attach Form 2439)	61			
	62 Total. Add lines 55 through 61 ▶			62	NONE
Refund or Balance Due	63 If line 62 is larger than line 54, enter amount OVERPAID ▶			63	
	64 Amount of line 63 to be REFUNDED TO YOU ▶			64	
	65 Amount of line 63 to be credited on 1980 estimated tax ▶	65			
	66 If line 54 is larger than line 62, enter BALANCE DUE. Attach check or money order for full amount payable to "Internal Revenue Service." Write your social security number on check or money order ▶ (Check ▶ ☒ If Form 2210 (2210F) is attached. See page 15 of instructions) $ 61			66	2,631

PLEASE SIGN HERE

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Sheldon B Buffard 4/15/80
Your signature Date

▶ Phyllis Buffard
Spouse's signature (if filing jointly, BOTH must sign even if only one had income)

Paid Preparer's Information

Preparer's signature and date ▶ | Check if self-employed ▶ ☐ | Preparer's social security no.

Firm's name (or your's if self-employed) and address ▶ | E.I. No. ▶ | ZIP code ▶

CFP104

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1		2 Employer's State number

3 Employer's name, address, and ZIP code	4 Correction ☐		
Compo Financial Services, Ltd. 21 Charles Street Westport, CT 06880	5 Employer's identification number 06-0993172		
	6 Advance EIC payment	7	
8 Employee's social security number 049-32-7803	9 Federal income tax withheld 0	10 Wages, tips, other compensation 4,500.00	11 FICA tax withheld 275.85	12 Total FICA wages 4,500.00
13 Employee's name (first, middle, last) Sheldon B. Bufferd,	14 Pension plan coverage? Yes/No NO	15 *	16 FICA tips
	18 State income tax withheld	19 State wages, tips, etc.	20 Name of state
11 Oak Lane Weston, CT 06333	21 Local income tax withheld	22 Local wages, tips, etc.	23 Name of locality
17 Employee's address and ZIP code	Copy B To be filed with employee's FEDERAL tax return This information is being furnished to the Internal Revenue Service.		

Form **W-2 Wage and Tax Statement 1979**

Department of the Treasury—Internal Revenue Service

21

21

2786 60004 - 1554

SCHEDULE A (Form 1040)
Department of the Treasury
Internal Revenue Service

ITEMIZED DEDUCTIONS
Attach to Form 1040

1979
08

Name(s) as shown on Form 1040

SHELDON B & PHYLLIS BUFFERD

Your social security number
049-32-7803

Medical and Dental Expenses

1 One half (but not more than $150) of insurance premiums for medical care. (Be sure to include in line 10 below) ▶	150
2 Medicine and drugs	
3 Enter 1% of line 31, Form 1040	
4 Subtract line 3 from line 2	
5 Enter balance of insurance premiums	150
6 Enter other medical and dental expenses:	
a) Doctors, dentists, nurses, etc.	
b) Hospitals	
c) Other (Itemize) ▶	
7 Total (add lines 4 through 6c)	150
8 Enter 3% of line 31, Form 1040	1,445
9 Subtract line 8 from line 7	
10 TOTAL (add lines 1 and 9) ▶	150

Taxes

11 State and local income	8
12 Real estate	2,532
13 General sales (see sales tax tables)	598
14 Personal property	139
15 Other (Itemize) ▶	
16 TOTAL TAXES (add lines 11 through 15) ▶	3,277

Interest Expense

17 Home mortgage	6,534
18 Credit and charge cards	14
19 Other (Itemize) ▶	
O NORWALK SAVINGS	138
ORD MOTOR CREDIT CORP	460
NTERNAL REVENUE SERVICE	72
20 TOTAL (add lines 17 through 19) ▶	7,218

Contributions

21 a) Cash contributions with receipts	1,765
b) Other cash contributions. List below ▶	
MISC. CHARITIES	25
22 Other than cash SEE STATEMENT	245
23 Carryover from prior years	
24 TOTAL (add lines 21a through 23) ▶	2,035

Casualty or Theft Loss

25 Loss before insurance reimbursement	
26 Insurance reimbursement	
27 Subtract line 26 from line 25	
28 Enter $100 or amount on line 27	
29 TOTAL (subtract line 28 from line 27) ▶	

Miscellaneous Deductions

30 Union dues	
31 Other (Itemize) ▶	
PROFESSIONAL LICENSE	75
32 TOTAL (add lines 30 and 31) ▶	75

A

39 Total deductions	12,755
40 If you checked Form 1040, Filing Status box: 2 or 5, enter $3,400; 1 or 4, enter $2,300; 3, enter $1,700	3,400
41 Subtract line 40 from line 39. Enter here and on Form 1040, line 33. (If line 40 is more than line 39, see the instructions	9,355

22

22

Schedule A & B (Form 1040) 1979 — **Schedule B - Interest and Dividend Income** —

Names as shown on Form 1040

SHELDON B & PHYLLIS BUFFERD

Your social security number 049-32-7803

Part I Interest Income

1 If you received more than $400 in interest, complete Part I and Part III. Please see page 9 of the instructions to find out what interest to report. Then answer the questions in Part III, below. If you received interest as a nominee for another, or you received or paid accrued interest on securities transferred between interest payment dates, please see page 18 of the instructions.

Name of payer	Amount
COUNTY FEDERAL S & L	154
SO. NORWALK SAVINGS	56
WESTPORT BANK & TRUST	257
INTERNAL REVENUE SERVICE	224
CONN NATIONAL BANK	20

2 Total interest income. Enter here and on Form 1040, line 9 711

Part II Dividend Income

3 If you received more than $400 in gross dividends (including capital gain distributions) and other distributions on stock, complete Part II and Part III. Please see page 9 of the instructions. Write (H), (W), (J), for stock held by husband, wife, or jointly. Then answer the questions in Part III, below. If you received dividends as a nominee for another, please see page 19 of the instructions.

Name of payer	Amount
(H) AMERICAN TEL & TEL	53

4 Total of line 3 53

5 Capital gain distributions. Enter here and on the appropriate line(s) on Schedule D. See Note below. .....

6 Nontaxable distributions .....

7 Total (add lines 5 and 6) .....

8 Dividends before exclusion (subtract line 7 from line 4) Enter here and on Form 1040, line 10a 53

Note: If your capital gain distributions for the year do not include any gains before Nov. 1, 1978 and you do not need Schedule D to report any gains or losses, do not file that schedule. Instead, enter the taxable part of your capital gain distributions on Form 1040, line 15.

Part III Foreign Accounts and Foreign Trusts

If you are required to list interest in Part I or dividends in Part II, OR if you had a foreign account or were a grantor of, or a transferor to a foreign trust, you must answer both questions in Part III. Please see page 19 of the instructions.

	Yes	No
A At any time during the tax year, did you have an interest in or signature or other authority over a bank account, securities account, or other financial account in a foreign country (see page 19 of instructions)?		X
B Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it? ..... If "Yes," you may be required to file Forms 3520, 3520-A, or 926.		X

B

CFP057

2786 60004 - 1554

SCHEDULE C (Form 1040) — PROFIT OR LOSS FROM BUSINESS OR PROFESSION

Department of the Treasury
Internal Revenue Service

(Sole Proprietorship)

▶ Partnerships, joint ventures, etc., must file Form 1065. ▶ Attach to Form 1040

YC132

1979

09

Name of proprietor: SHELDON B BUFFERD

Social security number of proprietor: 049-32-7803

A Main business activity (see Instructions) ▶ SERVICE product ▶ PUBLIC ACCOUNTANCY

B Business name ▶ SHELDON B BUFFERD, CPA

C Employer identification number: 06-6144995

D Business address (number and street) ▶ 21 CHARLES ST.
City, State and Zip Code ▶ WESTPORT, CT 06880

E Accounting method: (1) [X] Cash (2) [ ] Accrual (3) [ ] Other (specify) ▶

F Method(s) used to value closing inventory: C

(1) [ ] Cost (2) [ ] Lower of cost or market (3) [ ] Other (if other, attach explanation)

	Yes	No
G Was there any major change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explantion.		
H Did you deduct expenses for an office in your home?		X
I Did you elect to claim amortization (under section 191) or depreciation (under section 167(o)) for a rehabilitated certified historic structure (see instructions)? (Amortizable basis (see instructions) ▶)		

24

Part I Income

1 a Gross receipts or sales	1a	135,925.		
b Returns and allowances	1b			
c Balance (subtract line 1b from line 1a)			1c	135,925
2 Cost of goods sold and/or operations (Schedule C-1, line 8)			2	
3 Gross profit (subtract line 2 from line 1c)			3	135,925
4 Other income (attach schedule)			4	2,325
5 Total income (add lines 3 and 4) ▶			5	138,250

Part II Deductions

6 Advertising		31 a Wages	48,818
7 Amortization		b Jobs credit	
8 Bad debts from sales or services		c WIN credit	
9 Bank charges		d Total credits	
10 Car and truck expenses	2,073	e Subtract line 31d from 31a	48,818
11 Commissions		32 Other expenses (specify):	
12 Depletion		a PAYROLL TAXES	3,782
13 Depreciation(explain in Sched. C-2)	1,268	b CONTRACT SERVICES	5,565
14 Dues and publications		c STAFF TRAVEL, TOLLS & PKNG	3,275
15 Employee benefit programs	264	d MEETINGS & ENTERTAINMENT	1,326
16 Freight(not included on Sched C-1)		e REGISTRATIONS, DUES &	
17 Insurance	650	f PROFESSIONAL DEVELOPMENT	1,320
18 Interest on business indebtedness	384	g MISCELLANEOUS EXPENSE	100
19 Laundry and cleaning		h	
20 Legal and professional services		i	
21 Office supplies	4,982	j	
22 Pension and profit-sharing plans		k	
23 Postage		l	
24 Rent on business property	7,549	m	
25 Repairs		n	
26 Supplies(not included on Sched C-1)		o	
27 Taxes	3017 35	p	
28 Telephone	2,356	q	
29 Travel and entertainment		r	
30 Utilities		s	

33 Total deductions (add amounts in columns for lines 6 through 32s) ▶	33	83,747
34 Net profit or (loss) (subtract line 33 from line 5). If a profit, enter on Form 1040, line 13, and on Schedule SE Part II, line 5a (or Form 1041, line 6). If a loss, go on to line 35 ▶	34	54,503

35 If you have a loss, do you have amounts for which you are not "at risk" in this business (see instructions)? [ ] Yes [ ] No

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24

SCHEDULE C-1. - Cost of Goods Sold and/or Operations

1 Inventory at beginning of year (if different from last year's closing inventory, attach explanation)			1	
2a Purchases	2a			
b Cost of items withdrawn for personal use	2b			
c Balance (subtract line 2b from line 2a)			2c	
3 Cost of labor (do not include salary paid to yourself)			3	
4 Materials and supplies			4	
5 Other costs (attach schedule)			5	
6 Add lines 1, 2c and 3 through 5			6	
7 Inventory at end of year			7	
8 Cost of goods sold and/or operations (subtract line 7 from 6). Enter here and on Part I, line 2 ▶			8	

SCHEDULE C-2. - Depreciation (See Schedule C Instructions for line 13)

If you need more space, please use Form 4562.

Description of property (a)	Date acquired (b)	Cost or other basis (c)	Depreciation allowed or allowable in prior years (d)	Method of computing Depreciation (e)	Life or rate (f)	Depreciation for this year (g)
1 Total additional first-year depreciation (do not include items listed below) ▶						
2 Other depreciation:						
Buildings						
Furniture and fixtures						
Transportation equipment						
Machinery and other equipment						
Other (Specify)						
SEE STATEMENT		7,358				1,268
3 Totals		7,358			3	1,268
4 Depreciation claimed in Schedule C-1					4	
5 Balance (subtract line 4 from line 3). Enter here and on Part II, line 13 ▶					5	1,268

SCHEDULE C-3. - Expense Account Information (See Schedule C Instructions for Schedule C-3)

Enter information for yourself and your five highest paid employees. In determining the five highest paid employees, add expense account allowances to the salaries and wages. However, you don't have to provide the information for any employee for whom the combined amount is less than $25,000, or for yourself if your expense account allowance plus line 34, page 1, is less than $25,000.

Name (a)	Expense account (b)	Salaries and Wages (c)
Owner		
1		
2		
3		
4		
5		

	Yes	No
Did you claim a deduction for expenses connected with:		
A Entertainment facility (boat, resort, ranch, etc.)?		
B Living accomodations (except employees on business)?		
C Conventions or meetings you or your employees attended outside the U.S. or its possessions? (See Instructions)		
D Employees' families at conventions or meetings?		
If "Yes", were any of these conventions or meetings outside the U.S. or its possessions? (See page 26 of instructions)		
E Vacations for employees or their families not reported on Form W-2?		

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SCHEDULE E (Form 1040)	**SUPPLEMENTAL INCOME SCHEDULE**	1979
Department of the Treasury Internal Revenue Service	▶ Attach to Form 1040. ▶ See instructions for Schedule E (Form 1040). (From pensions & annuities, rents & royalties, partnerships, estates & trusts, etc.)	13

Name(s) as shown on Form 1040
SHELDON B & PHYLLIS BUFFERD

Your social security number
049-32-7803

Part I Pension and Annuity Income. If fully taxable, do not complete this part. Enter amount on Form 1040, line 17. For one pension or annuity not fully taxable, complete this part. If you have more than one pension or annuity that is not fully taxable attach a separate sheet listing each one with the appropriate data and enter combined total of taxable parts on line 4.

1a Did you and your employer contribute to the pension or annuity? ☐ Yes ☐ No

b If "Yes," do you expect to get back your contribution within 3 years from the date you receive the first payment? ☐ Yes ☐ No

c If "Yes," show: Your contribution ▶ $ _____ , d Contribution received in prior years ▶ 1d

2 Amount received this year 2

3 Amount on line 2 that is not taxable 3

4 Taxable part (subtract line 3 from line 2). Enter here and include in line 18 below 4

Part II Rent and Royalty Income or Loss. If you need more space, attach a separate sheet.

5a Have you claimed expenses connected with your vacation home(or other dwelling unit)rented to others(see instructions)? ☐ Yes ☐ No

b If "Yes," did you or any of your family occupy the vacation home(or other dwelling unit)for over 14 days in the tax year? ☐ Yes ☐ No

6a Did you elect to claim amortization(under section 191)or depreciation(under section 167(o))for a rehabilitated certified historic structure (see instructions)? ☐ Yes ☐ No

b Amortization basis (see instructions) ▶

(a) Property code (describe in Part V)	(b) Total amount of rents	(c) Total amount of royalties	(d) Depreciation (explain in Part VI) or depletion (attach computation)	(e) Other expenses (explain in Part VII)	(f) Loss	(g) Income
Property A						
Property B						
Property C						
Property D						
Property E						
7 Amounts from Form 4835						
8 Totals					( )	

9 Total rent and royalty income or(loss). Combine amounts in columns (f) and (g), line 8. Enter here and include in line 18 below 9

Part III Income or Losses from--

	(a) Name	(b) Employer Identification number	(c) Loss	(d) Income
Partnerships	SEE STATEMENT			
	10 Add amounts in columns (c) and (d) and enter here	10	(11,050)	
	11 Combine amounts in columns (c) and (d), line 10, and enter net income or(loss)	11		-11,050
	12 Additional first-year depreciation	12	( )	
	13 Total partnership income or(loss). Combine lines 11 and 12. Enter here and include in line 18 below	13		-11,050
Estates or Trusts				
	14 Add amounts in columns (c) and (d) and enter here	14	( )	
	15 Total estate or trust income or(loss). Combine amounts in columns (c) and (d), line 14. Enter here and include in line 18 below	15		
Small Business Corporations	SEE STATEMENT			
	16 Add amounts in columns (c) and (d) and enter here	16	(500)	
	17 Total small business corporation income or(loss). Combine amounts in columns (c) and (d), line 16. Enter here and include in line 18 below	17		-500

Part IV

18 TOTAL income or (loss). Combine lines 4, 9, 13, 15, and 17. Enter here and on Form 1040, line 18 ▶ 18 -11,550

19 Enter your share of gross farming and fishing income applicable to Parts II and III 19 E

26

21

Part V Property reported in Part II

Property Codes	Kind and location of property
A	
B	
C	
D	
E	

Schedule of depreciation claimed in column (d), Part II.

Part VI

	(a) Description of property	(b) Date acquired	(c) Cost or other basis	(d) Depreciation allowed or allowable in prior years	(e) Depreciation method	(f) Life or rate	(g) Depreciation for this year
Total additional first year depreciation (do not include in items below) →							
Property A							
	Totals (Property A)						
Total additional first year depreciation (do not include in items below) →							
Property B							
	Totals (Property B)						
Total additional first year depreciation (do not include in items below) →							
Property C							
	Totals (Property C)						
Total additional first year depreciation (do not include in items below) →							
Property D							
	Totals (Property D)						
Total additional first year depreciation (do not include in items below) →							
Property E							
	Totals (Property E)						

Part VII Expenses claimed in Part II

Expenses (Description)	PROPERTIES				
	A	B	C	D	E
Totals					

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SCHEDULE SE (Form 1040)
Department of the Treasury
Internal Revenue Service

COMPUTATION OF SOCIAL SECURITY SELF-EMPLOYMENT TAX

▶ See Instructions for Schedule SE (Form 1040)
▶ Attach to Form 1040.

1979

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NAME OF SELF-EMPLOYED PERSON (AS SHOWN ON SOCIAL SECURITY CARD)

SHELDON B BUFFERD

Social security number of self-employed person ▶ 049-32-7803

Part I Computation of Net Earnings from FARM Self-Employment

REGULAR METHOD			
1 Net profit or (loss) from:			
a Schedule F	1a		
b Farm partnerships	1b		
2 Net earnings from farm self-employment (add lines 1a and b)	2		
FARM OPTIONAL METHOD			
3 If gross profits from farming are:			
a Not more than $2,400, enter two-thirds of the gross profits	3		
b More than $2,400 and the net farm profit is less than $1,600. Enter $1,600			
4 Enter here and on line 12a, the amount on line 2, or line 3 if you elect the farm optional method	4		

Part II Computation of Net Earnings from NONFARM Self-Employment

SE

REGULAR METHOD			
5 Net profit or (loss) from:			
a Schedule C (Form 1040)	5a	54,503	
b Partnerships, joint ventures, etc. (other than farming)	5b		
c Service as a minister, member of a religious order, or a Christian Science practitioner. (Include rental value of parsonage or rental allowance furnished.) If you filed Form 4361 and have not revoked that exemption, check here ▶ ☐ and enter zero on this line	5c		
d Service with a foreign government or international organization	5d		
e Other	5e		
6 Total (add lines 5a through e)	6	54,503	
7 Enter adjustments ▶	7		
8 Adjusted net earnings or (loss) from nonfarm self-employment (line 6, as adjusted by line 7)	8	54,503	
Note: If line 8 is $1,600 or more **OR** if you do not elect to use the Nonfarm Optional Method, skip lines 9 through 11 and enter amount from line 8 on line 12b, Part III.			
NONFARM OPTIONAL METHOD			
9 a Maximum amount reportable, under both optional methods combined (farm and nonfarm)	9a	$1,600	00
b Enter amount from line 3. (If you did elect to use the farm optional method, enter zero)	9b		
c Balance (subtract line 9b from line 9a)	9c		
10 Enter two-thirds of gross nonfarm profits or $1,600, whichever is smaller	10		
11 Enter here and on line 12b, the amount on line 9c or line 10, whichever is smaller	11		

Part III Computation of Social Security Self-Employment Tax

12 Net earnings or (loss):				
a From farming (from line 4)			12a	
b From nonfarm (from line 8, or 11 if you elect to use the Nonfarm Optional Method)			12b	54,503
13 Total net earnings or (loss) from self-employment reported on line 12a and 12b. (If line 13 is less than $400, you are not subject to self-employment tax. Do not fill in rest of schedule			13	54,503
14 The largest amount of combined wages and self-employment earnings subject to social security or railroad retirement taxes for 1979 is			14	22,900
15 a Total "FICA" wages (from Forms W-2) and "RRTA" compensation	15a	4,500		
b Unreported tips subject to FICA tax from Form 4137, line 9 or to RRTA	15b			
c Total of lines 15a and b			15c	4,500
16 Balance (subtract line 15c from line 14)			16	18,400
17 Self-employment income--line 13 or 16, whichever is smaller			17	18,400
18 Self-employment tax. (If line 17 is $22900, enter $1855; if less, multiply the amount on line 17 by .081) Enter here and on Form 1040, line 48			18	1,490

28

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Form **3468**
Department of the Treasury
Internal Revenue Service

COMPUTATION OF INVESTMENT CREDIT

▶ Attach to your tax return.

1979
22

Name

SHELDON B & PHYLLIS BUFFERD

Identifying number as shown on page 1 of your tax return

049-32-7803

Check the applicable box(es) below to elect the provisions of the specified code section(s):

A The corporation elects the basic or basic and matching ESOP percentage under section 48(n)(1) . . . . . ☐

B I elect to increase my qualified investment to 100% for certain commuter highway vehicles under section 46(c)(6) . . . . . ☐

C I elect to increase my qualified investment under section 46(d) by all qualified progress expenditures made in the tax year and all subsequent years . . . . . ☐

1 Use the format below to list your qualified investment in new or used property acquired or constructed and placed in service during the tax year. Also list (a) qualified progress expenditures made during the tax year and certain prior tax years and (b) qualified rehabilitation expenditures for the year. See the instructions for line 1(a) through 1(j).

If you are claiming 100% investment credit on certain ships, check this block ▶ ☐. See instruction K for details.
Note: Include your share of investment in property made by a partnership, estate, trust, small business corporation, or lessor.

Type of property		Line	(1) Life years	(2) Cost or basis (See instruction G)	(3) Applicable percentage	(4) Qualified investment (Column 2 x column 3)
New property		(a)	3 or more but less than 5		33 1/3	
		(b)	5 or more but less than 7		66 2/3	
		(c)	7 or more	204,000	100	204,000
Commuter highway vehicle		(d)	3 or more		100	
Qualified progress expenditures	1974 through 1978	(e)	7 or more		20	
	1979	(f)	7 or more		100	
Used property (See instructions for dollar limitation)		(g)	3 or more but less than 5		33 1/3	
		(h)	5 or more but less than 7		66 2/3	
		(i)	7 or more	372	100	372
Commuter highway vehicle		(j)	3 or more		100	

2 Qualified investment--Add lines 1(a) through (j) (see instruction M for special limits)	204,372
3 10% of line 2	20,437
4 7% (4% for public utility property) of certain property (see instruction Q)	
5 Corporations electing the basic or basic and matching ESOP percentage for contributions to ESOPs--Check election box A above (see instruction 1 and instruction for line 5)	
a) Basic 1% credit--Enter 1% of line 2	
b) Matching credit (not more than 0.5%)--Enter allowable percentage adjusted line 2	
6 Patron's regular investment credit--Enter credit allocated from cooperative	
7 Total--Add lines 3 through 6	20,437
8 Carryover of unused credit(s)	
9 Carryback of unused credit(s)	
10 Tentative regular investment credit--Add lines 7, 8, and 9	20,437
Tax Liability Limitations	
11 (a) Individuals -- Enter amount from Form 1040, line 37, page 2	
(b) Estates and trusts--Enter amount from Form 1041, line 27, page 1	8,023
(c) Corporations--Enter amount from Schedule J (Form 1120), line 3, page 3	
12 (a) Credit for the elderly (individuals only)	
(b) Foreign tax credit	
(c) Tax on lump-sum distribution from Form 4972 or Form 5544	
(d) Possessions corporation tax credit (corporations only)	
(e) Section 72(m)(5) penalty tax (individuals only)	
13 Total--Add lines 12(a) through (e)	0
14 Subtract line 13 from line 11	8,023
15 (a) Enter smaller of line 14 or $25,000. See instruction M for special limits. (Married persons filing separately, controlled corporate groups, estates, and trusts, see instruction for line 15).	8,023
(b) If line 14 is more than line 15(a) and you are a 1979 calendar year taxpayer, enter 60% of the excess (if your tax year ends in 1980, enter 70% of the excess). (Public utilities, railroads, and airlines, see instruction J.)	0
16 Regular investment credit limitation--Add lines 15(a) and (b)	8,023

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(Continue computation on back.)

29

29

17 Allowed regular investment credit--Enter smaller of line 10 or line 16	8,023
Note: If line 10 exceeds line 16, the excess is an unused regular investment credit. See instruction F.	
18 Nonrefundable business energy investment credit limitation--Subtract line 17 from line 14	0
19 Enter nonrefundable business energy investment credit from line 8 of Schedule B (Form 3468)	0
20 Allowed nonrefundable business energy investment credit--Enter smaller of line 18 or line 19	0
Note: If line 19 exceeds line 18, the excess is an unused nonrefundable business energy investment credit. See instruction F.	
21 Total allowed regular investment credit and nonrefundable business energy investment credit--Add lines 17 and 20. Enter here and on Form 1040, line 41; Schedule J (Form 1120), line 4(b), page 3; or the appropriate line on other returns	8,023

Schedule A If any part of your investment in line 1 or 4 above was made by a partnership, estate,trust, small business corporation, or lessor, complete the following statement and identify property qualifying for the 7% or 10% investment credit.

Name & Address	Property			Life Years
	Progress Expenditures	New	Used	
COMPO FINANCIAL SERVICES, LT		204,000		7 +

If property is disposed of prior to the life years used in computing the investment credit, see instruction E

30

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Form **6251**

Department of the Treasury
Internal Revenue Service

ALTERNATIVE MINIMUM TAX COMPUTATION

► Attach to Forms 1040, 1041 or 990-T (Trust).

1979
30

30T

Name(s) as shown on tax return
SHELDON B & PHYLLIS BUFFERD

Identifying number
049-32-7803

1 Adjusted gross income from Form 1040, line 32 (estates and trusts--see instructions)			1	48,164
2 Deductions (applies to individuals only):				
a Enter amount from Form 1040, line 33	2a	9,355		
b On your 1979 Form 1040, if you checked Filing Status box. [2 or 5, enter $3,400; 1 or 4, enter $2,300; 3, enter $1,700]	2b	3,400		
c Multiply $1,000 by the total number of exemptions on Form 1040, line 7	2c	4,000		
d Add lines 2a through 2c (estates and trusts, enter zero)			2d	16,755
3 Subtract line 2d from line 1			3	31,409
4 Tax preference items:				
a Adjusted itemized deductions	4a			
b Capital gain deduction	4b			
c Add lines 4a and 4b			4c	
5 Alternative minimum taxable income (add lines 3 and 4c)			5	31,409
6 Enter $20,000 ($10,000 if married filing separately, or an estate or trust)			6	20,000
7 Subtract line 6 from line 5. If zero or less, do not complete the rest of this form			7	11,409
8 Enter the smaller of line 7 or $40,000 ($20,000 if married filing separately or an estate or trust)	8	11,409		
9 Subtract line 8 from line 7	9			
10 Enter the smaller of line 9 or $40,000 ($20,000 if married filing separately or an estate or trust)	10			
11 Subtract line 10 from line 9	11			
12 Enter 10% of line 8	12	1,141		
13 Enter 20% of line 10	13			
14 Enter 25% of line 11	14			
15 Add lines 12, 13 and 14			15	1,141
16 Amount from Form 1040, line 47* (estates and trusts--see instructions)	15			
17 Minimum tax from Form 1040, line 49a (estates and trusts--see instructions)	17			
18 Tax from recomputing prior-year investment credit (from Form 1040, line 50) (estates and trusts--see instructions)	18			
19 Tax from recomputing prior-year work incentive (WIN) credit	19			
20 Add lines 16 through 19			20	
21 Alternative minimum tax (subtract line 20 from line 15). If zero or less, do not complete the rest of this form			21	1,141
22 Foreign tax credit (see instructions)			22	
23 Subtract line 22 from line 21. Enter here and on Form 1040, line 49b (estates and trusts--see instructions			23	1,141

*Do not include any tax from Form 4970, Form 4972, Form 5544, or any penalty tax under section 72(m)(5).

Form **6251** (1979)

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STATEMENT SUPPORTING SCHEDULE E -

INCOME OR LOSS FROM PARTNERSHIP

NAME OF PARTNERSHIP	EMP ID NO	ADDL 1ST YR DEPCN	GROSS FM OR FISH INC	LOSS	INCOME
PRINTER ASSOCIATES 50 CENTRAL SQ. KEENE, NH	02-0343801			11,050	
TOTALS				11,050	

INCOME OR LOSS FROM SMALL BUSINESS CORPS

NAME OF SMALL BUSINESS CORP	EMP ID NO	LOSS	INCOME
COMPO FINANCIAL SERVICES, LTD 21 CHARLES ST WESTPORT, CT	06-0993172	500	
TOTALS		500	

STATEMENT SUPPORTING SCHEDULE A - CONTRIBUTIONS
NON-CASH CONTRIBUTION-LINE 22

50 PERCENT CONTRIBUTIONS CLOTHING TO GOODWILL IND. AT EST F.M.V. (15PCT OF COST	245.
TOTAL	245.

GOODWILL INDUSTRIES
OF WESTERN CONNECTICUT
MAIN PLANT
165 OCEAN TERRACE - BRIDGEPORT - TEL. 368-6511

CALL TAKEN AT
☐ BPT. ☐ MIL. ☐ WPT. ☐ NOR. ☐ DANB. ☐ WAT.

PHONE: 227-7371

☐ MR. MRS. MISS. Sheldon Bufford

COLLECTION DATE 6/5/79

ST. 11 Oak Lane

CITY Weston Conn

DATE TAKEN 6/1/79 BY. H.H ☐ SPEC. INST. ATTACHED

ITEMS TO BE COLLECTED	VERIFICATION OF DONATION
[illegible] - 3	girls skirt - 2
womens coat - 1	girls [illegible] - 1 [illegible] - 2
womens [illegible] - 1	girls slacks 1 2
[illegible] - 4	[illegible] - 1
ladies slacks - 1	mens slacks - 6
ladies robe - 2	mens shirts - 6
[illegible] - 3	mens suits - 4
[illegible] - 1	mens sweaters - 4
[illegible] - 1	mens [illegible] - 1

DRIVER DONOR

THIS IS YOUR RECEIPT FOR TAX PURPOSES. VALUE SHOULD BE BASED ON PURCHASE PRICE MINUS DEPRECIATION. THE DONOR IS RESPONSIBLE TO DETERMINE THE VALUE OF THE ITEMS.

NUMBER B 47775

Your gift provides services to the handicapped. Visit our plant! See how your material is used!

TAX LETTER ☐ COMPLETE ☐ TIME OUT ______ SEE OTHER SIDE ☐

DONOR'S COPY

GOODWILL INDUSTRIES
OF WESTERN CONNECTICUT
MAIN PLANT
165 OCEAN TERRACE - BRIDGEPORT - TEL. 368-6511

CALL TAKEN AT
☐ BPT. ☐ MIL. ☐ WPT. ☒ NOR. ☐ DANB. ☐ WAT.

PHONE: 227-7371

☐ Sheldon Bufford

MR. (MRS.) MISS.

COLLECTION DA

ST. 11 Oak Lane

CITY Weston, Conn

DATE TAKEN 6/3/79 BY. H.H ☐ SPEC. INST. ATTACHED

ITEMS TO BE COLLECTED	VERIFICATION OF DONATION
girls ski jacket - 1	[illegible]
women's robe - 2	[illegible] outfit - 2
girls slacks - 1	[illegible]
women's [illegible] - 2	[illegible]
women's [illegible] - 3	[illegible]
women's shirt - 1	[illegible]
[illegible] - 18	[illegible]
women's [illegible] - 1	[illegible] - 1
[illegible] - 1	

DRIVER DONOR

THIS IS YOUR RECEIPT FOR TAX PURPOSES. VALUE SHOULD BASED ON PURCHASE PRICE MINUS DEPRECIATION. THE DONOF RESPONSIBLE TO DETERMINE THE VALUE OF THE ITEMS.

NUMBER B 49937

Your gift provides services to the handicap. Visit our plant! See how your material is u

TAX LETTER ☐ COMPLETE ☐ TIME OUT ______ SEE OTHER SIDE ☐

DONOR'S COPY

049-32-7803 S. BUFFERD 2786 60004 - 1554 FED

SOC SEC NUMBER TAXPAYER'S NAME

DEPRECIATION STATEMENT

SCHEDULE C-1 SHELDON B BUFFERD, CPA (PAGE NO.01) 1979 YEAR

N = NEW U = USED

DESCRIPTION OF PROPERTY	DATE ACQUIRED	METHOD OF DEPREC.	LIFE	COST OR OTHER BASIS	SALVAGE VALUE	ADJUSTMENT TO BASIS: PRIOR ACCUM DEPRECIATION	ADJUSTMENT TO BASIS: 20% ADDIT FIRST YEAR BONUS	N-U	DEPRECIATION THIS YEAR	TENTATIVE INVESTMENT CREDIT
AUTOMOBILE	01 06 77	SL	04 YRS	4,750	300	2000		M	1,000	
PERSONAL PORTION INCLUDED THEREIN	01 06 77	SL	04 YRS	-450					0	
OFFICE FURNITURE & EQUIPMENT	00 00 74	SL	10 YRS	850		382		M	85	
OFFICE FURNITURE & EQUIPMENT	00 00 74	SL	05 YRS	150		135		M	15	
OFFICE FURNITURE & EQUIPMENT	00 00 78	SL	05 YRS	320		48		M	64	
OFFICE FURNITURE & EQUIPMENT	00 00 76	SL	10 YRS	340		8		M	34	
OFFICE FURNITURE & EQUIPMENT	00 00 79	SL	10 YRS	372				M	6	U 37
LEASEHOLD IMPROVEMENTS	00 00 79	SL	04 YRS	1,026				M	64	
TOTALS				7,358		2,573			1,268	37
ADD 20% ADDITIONAL DEPRECIATION ON ITEMS PURCHASED THIS YEAR (DENOTED BY *) -									0	
TOTAL DEPRECIATION									1,268	

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P - PREFERENCE ITEM FOR MINIMUM/MAXIMUM TAX
F - FOR FEDERAL PURPOSE ONLY
S - FOR STATE PURPOSES ONLY
M - DEPRECIATION NOT COMPUTER CALCULATED
INV CR - INVESTMENT CREDIT TAKEN IN PRIOR YEARS

(1) METHOD OF DEPRECIATION CHANGED TO SL. PRIOR YEAR DB. DEPREC. INCLUDED IN SALVAGE

2786 60004 - 1554

Form **2210**

Department of the Treasury
Internal Revenue Service

UNDERPAYMENT OF ESTIMATED TAX BY INDIVIDUALS

► Attach to Form 1040. ► See Instructions on back.

1979

Name(s) as shown on Form 1040
SHELDON B & PHYLLIS BUFFERD

Social security number
049-32-7803

Part I HOW TO FIGURE YOUR UNDERPAYMENT (Complete lines 1 through 17)

If you meet any of the exceptions to the underpayment penalty for ALL four periods skip lines 1 through 17 and go directly to line 18.

1 1979 tax (from Form 1040, line 54)		2,631
2 Earned income credit (from Form 1040, line 57)		
3 Tax credit for special fuels and oils (from Form 1040, line 60)		
4 Minimum tax (from Form 1040, line 49a)		
5 Alternative minimum tax (from Form 1040, line 49b)	1,141	
6 Social security (FICA) tax on unreported tip income (from Form 1040, line 51a)		
7 Uncollected FICA and RRTA tax on tips (from Form 1040, line 51b)		
8 Tax on IRA (from Form 5329, Part I or III included on Form 1040, line 52)		
9 Refundable business energy credit (from Schedule B (Form 3468) included on Form 1040, line 62)		
10 Total (add lines 2 through 9)		1,141
11 Balance (subtract line 10 from line 1)		1,490
12 Enter 80% of the amount shown on line 11		1,192

	Payment Due Dates			
	(a) Apr. 15, 1979	(b) June 15, 1979	(c) Sept. 15, 1979	(d) Jan. 15, 1980
13 Divide amount on line 12 by the number of payments required for the year. Enter the result in appropriate columns	298	298	298	298
14 Amounts paid on estimated tax and tax withheld				
15 Overpayment (on line 17) from previous period				
16 Total (add lines 14 and 15)				
17 Underpayment (subtract line 16 from line 13) OR Overpayment (subtract line 13 from line 16)	298 XXXXXXXX	298 XXXXXXXX	298 XXXXXXXX	298 XXXXXXXX

Part II EXCEPTIONS TO THE PENALTY (Farmers and fishermen, see Instruction A for special exception)

18 Total amount paid and withheld from January 1 through the payment due date shown				
19 Exception 1 - 1978 tax ► $	25% of 1978 tax	50% of 1978 tax	75% of 1978 tax	100% of 1978 tax
20 Exception 2 - Tax on 1978 income using 1979 rates and exemptions (attach computation)	Enter 25% of tax	Enter 50% of tax	Enter 75% of tax	Enter 100% of tax
21 Exception 3 - Tax on annualized 1979 income (see worksheet on back)	Enter 20% of tax	Enter 40% of tax	Enter 60% of tax	Not applicable
22 Exception 4 - Tax on 1979 income over 3, 5 and 8-month periods (attach computation)	Enter 90% of tax	Enter 90% of tax	Enter 90% of tax	

Part III HOW TO FIGURE THE PENALTY (Complete lines 23 through 27)

23 Amount of underpayment (from line 17)				
24 Date of payment	SEE			
25 (a) Number of days after due date of payment to and including date of payment or January 31, 1980, whichever is earlier	STATEMENT			
(b) Number of days from and including February 1, 1980, to and including date of payment or April 15, 1980, whichever is earlier		ATTACHED		
26 (a) 6 percent a year on the amount shown on line 23 for the number of days shown on line 25(a)				
(b) 12 percent a year on the amount shown on line 23 for the number of days shown on line 25(b)				

27 Penalty (add amounts on lines 26(a) and (b)). Check the box below line 66 on Form 1040 and show this amount in the space provided. If you owe tax on line 66, include the penalty amount with your total payment. If you are due a refund, we will subtract the penalty amount from the amount on line 63 — 61

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CFP011

Form 2210 (1979)

GE 2 OE 2210 2786 60004 - 1554

Statement Supporting Form 2210 Penalty Calculation

INSTALL DUE DATE	AMOUNT OF UNDERPMT	AMOUNT PAID	DATE PD. OR 4/15	NO.OF DAYS TO 1/31	NO.OF DAYS TO 4/15	PENALTY 6-PCT	PENALTY 12-PCT
4/15/79	298		04/15/80	291	75	14	7
		TOTAL PERIOD		291	75	14	7
6/15/79	298		04/15/80	230	75	11	7
		TOTAL PERIOD		230	75	11	7
9/15/79	298		04/15/80	138	75	7	7
		TOTAL PERIOD		138	75	7	7
1/15/80	298		04/15/80	16	75	1	7
		TOTAL PERIOD		16	75	1	7

TOTAL PENALTY 61

2-C

Form 2553 (Rev. May 1975)
Department of the Treasury
Internal Revenue Service

Election by a Small Business Corporation

(As to taxable status under Subchapter S of the Internal Revenue Code)

File in duplicate

NOTE.—This election under section 1372(a) (with the consent of all your stockholders) to be treated as an "electing small business corporation" for income tax purposes may be made only if the corporation meets all six of the requirements stated in instruction A.

Name of corporation	Employer identification number (see instr. L)	Principal business activity (see instr. E)
COMPO FINANCIAL SERVICES, LTD	~~PENDING~~ 06-0993175	FINANCIAL MANAGEMENT
Number and street: 21 Charles Street	12-26-78	Election is to be effective for the taxable year beginning (Mo., day, year): ~~DECEMBER 26, 1978~~
City or town, State and ZIP code: WESTPORT, CONN.		Number of shares issued and outstanding: 900

Is the corporation the outgrowth or continuation of any form of predecessor? ☐ Yes ☒ No. If "Yes," state name of predecessor, type of organization, and period during which it was in existence. .....

Date and place of incorporation: 12/26/78, Conn.

If this election is effective for the first taxable year the corporation is in existence, submit the following information:

Date corporation first had shareholders	Date corporation first had assets	Date corporation began doing business	Annual return will be filed for taxable year ending (Month)
DECEMBER 26, 1978	DECEMBER 26, 1978	DECEMBER 26, 1978	NOVEMBER

Name and address (including ZIP code) of each shareholder	Stock: No. of shares	Stock: Date(s) acquired (see instr. D)	Social Security Number	Internal Revenue Service Center where individual return is filed
1 EMIL A. REISNER 11 YANKEE HILL RD., WESTPORT, CT06880	450	12/26/78	285-24-7963	ANDOVER, MASS.
2 SHELDON B. BUFFERD 11 Oak Lane, Weston, Ct. 06883	450	12/26/78	049-32-7803	ANDOVER, MASS.
3				
4				
5				
6				
7				
8				
9				
10				

NOTE.—For this election to be valid, the consent of each stockholder must accompany this form or be shown below. See instruction D.

Under penalties of perjury, I declare that I have examined this election, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

Signature and Title of Officer ▶ ..... Date ....., 19.....

Shareholders' statement of consent (May be used in lieu of attachments—see instruction D)

We the undersigned shareholders consent to the election of the above corporation to be treated as an "electing small business corporation" under section 1372(a).

Signature of shareholders and date			
1 Emil A Reisner	12/25/78	6	
2 Sheldon B Bufferd	12/29/78	7	
3		8	
4		9	

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3-C

Revised In Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Form **1120S**
Department of the Treasury
Internal Revenue Service

U.S. Small Business Corporation Income Tax Return

for calendar year 1978 or other tax year beginning Dec. 26, 1978, ending Nov. 30, 19 79

1978

A Date of election as small business corporation: 12/29/78

B Business code no. (see page 7 of instructions): 7389

Use IRS label. Otherwise, please print or type.

PO 06-0993172 NOV 30,1979 D06 N
COPPO FINANCIAL SERVICES LTD
21 CHARLES ST
WESTPORT CT 06880 IRS

C Employer identification no. (see instruction S): 06-0993172

D Date incorporated: 12/26/78

E Enter total assets from Schedule L, line 14, column (D) (see instruction T): $ 280,007.

IMPORTANT—All applicable lines and schedules must be filled in. If the space on the schedules is not sufficient, see instruction N.
Note: *If section 465 (deductions limited to amount at risk) applies, see instruction for line 28.*

Gross Income	1 Gross receipts or gross sales ..... Less: Returns and allowances	1	4,000.
	2 Less: Cost of goods sold (Schedule A) or operations (attach schedule)	2	
	3 Gross profit	3	4,000
	4 (a) Domestic dividends	4(a)	
	(b) Foreign dividends	4(b)	
	5 Interest on obligations of the U.S. and U.S. instrumentalities	5	
	6 Other interest	6	540
	7 Gross rents	7	
	8 Gross royalties	8	
	9 Gains and losses (attach separate Schedule D (Form 1120S)):		
	(a) Net short term capital gain reduced by any net long-term capital loss	9(a)	
	(b) Net capital gain (if more than $25,000, see instructions for Part IV of Schedule D (Form 1120S))	9(b)	
	(c) Ordinary gain or (loss) from Form 4797, Part II, line 11 (attach Form 4797)	9(c)	
	10 Other income (see instructions—attach schedule)	10	(107,399)
	11 TOTAL income—Add lines 3 through 10	11	(102,859)
Deductions	12 Compensation of officers (Schedule E)	12	
	13 (a) Salaries and wages ..... 13(b) Less jobs credit ..... Balance ▶	13c	
	14 Repairs (see instructions)	14	
	15 Bad debts (Schedule F if reserve method is used)	15	
	16 Rents	16	
	17 Taxes	17	
	18 Interest	18	
	19 Contributions (not over 5% of line 28 adjusted per instructions—attach schedule)	19	
	20 Amortization (attach schedule)	20	134
	21 Depreciation from Form 4562 (attach Form 4562) ..... less depreciation claimed in Schedule A and elsewhere on return ..... Balance ▶	21	
	22 Depletion (attach schedule)	22	
	23 Advertising	23	
	24 Pension, profit-sharing, etc. plans (see instructions) (enter number of plans ▶ .....)	24	
	25 Employee benefit programs (see instructions)	25	
	26 Other deductions (attach schedule)	26	
	27 TOTAL deductions—Add lines 12 through 26	27	134
	28 Taxable income (subtract line 27 from line 11) (see instructions)	28	(102,993)
Tax	29 Income tax on capital gains (Schedule D (Form 1120S), Part IV)	29	
	30 Minimum tax (see instructions—attach Form 4626)	30	
	31 Total tax (add lines 29 and 30)	31	None
	32 Credits: (a) Tax deposited with Form 7004 — 32(a)		
	(b) Tax deposited with Form 7005 (attach copy) — 32(b)		
	(c) Credit for U.S. tax on special fuels, nonhighway gas, and lubricating oil (attach Form 4136) — 32(c)		
	33 TAX DUE (subtract line 32 from line 31). See instruction G for depositary method of payment ▶	33	None
	34 OVERPAYMENT (subtract line 31 from line 32) ▶	34	

RECEIVED I.R.S. 01812 FEB - 1 1980 ANDOVER, MA

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Sheldon B Coppard — Signature of officer — Date

▶ Treasurer — Title

Paid Preparer's Information

Preparer's signature ▶

Preparer's social security no.

Check if self-employed ▶ ☐

Firm's name (or yours, if self-employed), address and ZIP code ▶

E.I. No. ▶

Date ▶

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Schedule A Cost of Goods Sold (See instruction 2)

1 Inventory at beginning of year	
2 Merchandise bought for manufacture or sale	
3 Salaries and wages	
4 Other costs (attach schedule)	
5 Total of lines 1 through 4	
6 Less: Inventory at end of year	
7 Cost of goods sold—Enter here and on line 2, page 1	

8 (a) Check valuation method(s) used for total closing inventory:
- ☐ Cost
- ☐ Lower of cost or market
- ☐ Other (if "other," attach explanation)

(b) Check if this is the first year LIFO inventory method was adopted and used . . . . . ☐
If checked, attach Form 970.

(c) If the LIFO inventory method was used for this taxable year, enter percentage (or amounts) of closing inventory computed under LIFO . . . . .

(d) Is the corporation engaged in manufacturing activities? . . . . . ☐ Yes ☐ No
If "Yes," are inventories valued under Regulations section 1.471-11 (full absorption accounting method)? . ☐ Yes ☐ No

(e) Was there any substantial change in determining quantities, cost, or valuations between opening and closing inventory? . . . . . ☐ Yes ☐ No
If "Yes," attach explanation.

Schedule E Compensation of Officers (See instruction 12)

1. Name of officer	2. Social security number	3. Time devoted to business	4. Percentage of corporation stock owned	5. Amount of compensation	6. Expense account allowances
Emil A. Reisner	285-24-7963	As Req.		0	
Sheldon B. Bufferd	049-32-7803	As Req.		0	
Total compensation of officers—Enter here and on line 12, page 1				None	

Schedule F Bad Debts—Reserve Method (See instruction 15)

1. Year	2. Trade notes and accounts receivable outstanding at end of year	3. Sales on account	Amount added to reserve: 4. Current year's provision	Amount added to reserve: 5. Recoveries	6. Amount charged against reserve	7. Reserve for bad debts at end of year
1973						
1974						
1975						
1976						
1977						
1978						

Additional Information Required

	Yes	No
F Did you at the end of the tax year own, directly or indirectly, 50% or more of the voting stock of a domestic corporation? (For rules of attribution, see section 267(c).)		X
If "Yes," attach a schedule showing: (1) name, address, and employer identification number; (2) percentage owned; (3) highest amount owed by you to such corporation during the year; and (4) highest amount owed to you by such corporation during the year. (*Note:* For purposes of F(3) and F(4), "highest amount owed" includes loans and accounts receivable/payable.)		
G Taxable income or (loss) from line 28, page 1, Form 1120S for your tax year beginning in: 1975 ▶ ; 1976 ▶ ; 1977 ▶		
H Refer to page 7 of instructions and state the principal: Business activity ▶ Service ; Product or service ▶ Financial, Leasing & Investment Counselling		
I Were you a member of a controlled group subject to the provisions of section 1561?		X
J Is the corporation engaged in any activity involving oil or gas, movies or video tapes, leasing section 1245 property to others, or farming which resulted in a loss (see instruction for line 28)?		X

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Compo Financial Services, Ltd. 06-0993172

Other Income (loss) - From Partnership

Printer Associates 02-0343801 50 Central Sq., Keene, NH		(107,399)

Amortization

Corporation elects to amortize organizational costs in accordance with IR Code:

Organization Costs	731	
Amortization - 11/60th's		134

Investment Credit Property

Share of Qualified Investment Credit Property from Printer Assoc., a Limited Partnership	2,040,000

Other Current Assets

Stock Subscriptions Receivable	1,000	-
Notes Receivable	-	137,250
	1,000	137,250

Other Investments

48 Units - Printer Associates, equity basis	-	132,601

		Yes	No
K (1)	Did you claim a deduction for expenses connected with:		
	(a) Entertainment facility (boat, resort, ranch, etc.)?		X
	(b) Living accommodations (except for employees on business)?		X
	(c) Employee's families at conventions or meetings?		X
	If "Yes," were any of these conventions or meetings outside the United States or its possessions?		
	(d) Employee or family vacations not reported on Form W-2?		X
(2)	Enter total amount claimed on Form 1120S for entertainment, entertainment facilities, gifts, travel, and conventions of the type for which substantiation is required under section 274(d). (See instruction U.) ▶		
L	Did you file all required Forms 1087, 1096, and 1099?	N/A	
M	Answer only if (1) this is the first 1120S return filed since your election to be treated as a small business corporation and (2) the corporation was in existence for the tax year prior to the election and had investment credit property: Was an agreement filed under section 1.47-4(b) of the regulations?	N/A	
N	Did you, at any time during the tax year, have an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country (see Instruction R)?		X
O	Were you the grantor of, or transferor to, a foreign trust during any tax year, which foreign trust was in being during the current tax year, whether or not you have any beneficial interest in such trust? If "Yes," you may be required to file Forms 3520, 3520-A, or 926		X

Schedule K-1 Computation of Undistributed Taxable Income and Summary of Distributions and Other Items

Computation of Corporation's Undistributed Taxable Income

1	Taxable income (line 28, page 1)	(102,993)
2	Less: (a) Money distributed as dividends out of earnings and profits of the tax year	
	(b) Tax imposed on certain capital gains (line 31, page 1)	
3	Corporation's undistributed taxable income	(102,993)
4	Actual dividend distributions taxable as ordinary income. (Do not include amounts shown on line 6)	
5	Actual dividend distributions taxable as long-term capital gains (after tax)	
6	Actual dividend distributions taxable as ordinary income and qualifying for dividend exclusion	
7	Nondividend distributions	
8	Undistributed taxable income—taxable as ordinary income or (loss)	(102,993)
9 (a)	Undistributed taxable income—taxable as long-term capital gain (after tax)	
(b)	Portion of line 9(a) attributable to transactions after 10-31-78 (after tax)	

				Cost or basis
10	Investment credit property			
Property Qualified for Investment Credit	Basis of new investment property	(a) 3 or more but less than 5 years		
		(b) 5 or more but less than 7 years		
		(c) 7 or more years		2,040,000
	Qualified progress expenditures	(d) 7 or more years	1974, 1975, 1976, and 1977	
		(e) 7 or more years	1978	
	Cost of used investment property	(f) 3 or more but less than 5 years		
		(g) 5 or more but less than 7 years		
		(h) 7 or more years		

11	Interest on investment indebtedness:	
(a) (1)	Interest on investment indebtedness incurred prior to December 17, 1969	
(2)	Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969	
(3)	Interest on investment indebtedness incurred after September 10, 1975	
(b)	Net investment income or (loss)	
(c)	Excess expenses from "net lease property"	
(d)	Net capital gain attributable to investment property	
12	Item of tax preference (see instructions):	
(a)	Accelerated depreciation on—	
(1)	Low income rental housing	
(2)	Other real property	
(3)	Personal property subjected to a lease	
(b)	Amortization: (1) ....., (2) ....., (3) ....., (4)	
(c)	Reserve for losses on bad debts of financial institutions	
(d)	Depletion	
(e)	Intangible drilling costs	
(f)	Net capital gain (after tax)	
13	New jobs credit or combined new jobs credit and targeted jobs credit	

Schedule L Balance Sheets

Assets	Beginning of tax year (A) Amount	Beginning of tax year (B) Total	End of tax year (C) Amount	End of tax year (D) Total
1 Cash				9559
2 Trade notes and accounts receivable				
(a) Less allowances for bad debts				
3 Inventories				
4 Gov't obligations: (a) U.S. and instrumentalities				
(b) State, subdivisions thereof, etc.				
5 Other current assets (attach schedule)		1,000		137,250
6 Loans to shareholders				
7 Mortgage and real estate loans				
8 Other investments (attach schedule)				132,601
9 Buildings and other fixed depreciable assets				
(a) Less accumulated depreciation				
10 Depletable assets				
(a) Less accumulated depletion				
11 Land (net of any amortization)				
12 Intangible assets (amortizable only)			731	
(a) Less accumulated amortization			134	597
13 Other assets (attach schedule)				
14 Total assets		1,000		280,007
Liabilities and Shareholders' Equity				
15 Accounts payable				
16 Mtges., notes, bonds payable in less than 1 year				135,000
17 Other current liabilities (attach schedule)				
18 Loans from shareholders				
19 Mtges., notes, bonds payable in 1 year or more				
20 Other liabilities (attach schedule)				
21 Capital stock		1,000		248,000
22 Paid-in or capital surplus				
23 Retained earnings—appropriated (attach schedule)				
24 Retained earnings—unappropriated				(102,993)
25 Shareholders' undistributed taxable income previously taxed				
26 Less cost of treasury stock		( )		( )
27 Total liabilities and shareholders' equity		1,000		280,007

Schedule M-1 Reconciliation of Income Per Books With Income Per Return

1 Net income per books	(102,993)	7 Income recorded on books this year not included in this return (itemize) (a) Tax-exempt interest $	
2 Federal income tax			
3 Excess of capital losses over capital gains		8 Deductions in this tax return not charged against book income this year (itemize) (a) Depreciation $	
4 Income subject to tax not recorded on books this year (itemize)			
5 Expenses recorded on books this year not deducted in this return (itemize) (a) Depreciation $		9 Total of lines 7 and 8	
6 Total of lines 1 through 5	(102,993)	10 Income (line 28, page 1)—line 6 less line 9	(102,993)

Schedule M-2 Analysis of Unappropriated Retained Earnings Per Books (line 24 above)

1 Balance at beginning of year	0	5 Distributions out of current or accumulated earnings and profits: (a) Cash	
2 Net income per books	(102,993)	(b) Stock	
3 Other increases (itemize)		(c) Property	
		6 Current year's undistributed taxable income or net operating loss (total of lines 8 and 9(a), Schedule K)	(102,993)
		7 Other decreases (itemize)	
		8 Total of lines 5, 6, and 7	(102,993)
4 Total of lines 1, 2, and 3	(102,993)	9 Balance at end of year (line 4 less line 8)	0

☆ U.S. GOVERNMENT PRINTING OFFICE: 1978—O-253-123 58-040-1110

SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year
beginning Dec. 26, 1978, ending Nov. 30, 19 79
(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(33140)	Schedule E, Part III
2 (a) Undistributed taxable income—net long-term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II

Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		

Part III Interest on Investment Indebtedness		Form 4952 line reference
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20

Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization: (a) ....., (b) ....., (c) ....., (d)		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		

Part V Property Eligible for Investment Credit			Form 3468 line reference
Basis of new investment property	(a) 3 or more but less than 5 years		line 1(a)
	(b) 5 or more but less than 7 years		line 1(b)
	(c) 7 or more years	204,000	line 1(c)
Qualified progress expenditures	(d) 7 or more years — 1974, 1975, 1976, and 1977		line 1(d)
	(e) 7 or more years — 1978		line 1(e)
Cost of used investment property	(f) 3 or more but less than 5 years		line 1(f)
	(g) 5 or more but less than 7 years		line 1(g)
	(h) 7 or more years		line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255.)

(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 x column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 x column 10)
A									
B									

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Emil A. Reisner 11 Yankee Hill Rd. Westport, CT 06880	285-24-7963	450	12-26-78	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
NONE	As Req.	Compo Financial Services, Ltd. '06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year beginning Dec. 26, 1978, ending Nov. 30, 1979

(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(33140)	Schedule E, Part III
2 (a) Undistributed taxable income—net long-term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II
Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		
Part III Interest on Investment Indebtedness		Form 4952 line reference
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20
Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization: (a) ....., (b) ....., (c) ....., (d)		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		

Part V Property Eligible for Investment Credit				Form 3468 line reference
Basis of new investment property	(a) 3 or more but less than 5 years			line 1(a)
	(b) 5 or more but less than 7 years			line 1(b)
	(c) 7 or more years		204,000	line 1(c)
Qualified progress expenditures	(d) 7 or more years	1974, 1975, 1976, and 1977		line 1(d)
	(e) 7 or more years	1978		line 1(e)
Cost of used investment property	(f) 3 or more but less than 5 years			line 1(f)
	(g) 5 or more but less than 7 years			line 1(g)
	(h) 7 or more years			line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255.)

(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 x column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 x column 10)
A									
B									

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Sheldon B. Bufferd 11 Oak Lane Weston, CT 06883	049-32-7803	450	12-26-78	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
None	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year
beginning Dec. 26, 1978, ending Nov. 30, 1979
(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(10527)	Schedule E, Part III
2 (a) Undistributed taxable income—net long-term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II
Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		Form 4952 line reference
Part III Interest on Investment Indebtedness		
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20
Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization: (a) ....., (b) ....., (c) ....., (d)		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		

Part V Property Eligible for Investment Credit				Form 3468 line reference
Basis of new investment property	(a) 3 or more but less than 5 years			line 1(a)
	(b) 5 or more but less than 7 years			line 1(b)
	(c) 7 or more years		136,000	line 1(c)
Qualified progress expenditures	(d) 7 or more years	1974, 1975, 1976, and 1977		line 1(d)
	(e) 7 or more years	1978		line 1(e)
Cost of used investment property	(f) 3 or more but less than 5 years			line 1(f)
	(g) 5 or more but less than 7 years			line 1(g)
	(h) 7 or more years			line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255)

(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 × column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 × column 10)
A									
B									

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Date of disposition
Ogden Bigelow Jr. 25 Hidden Lake Ridge Wilton, CT 06897	040-22-0291	300	6-22-79	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
None	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year
beginning Dec. 26, 1978, ending Nov. 30, 1979
(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
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Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(5523)	Schedule E, Part III
2 (a) Undistributed taxable income—net long term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II
Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		
Part III Interest on Investment Indebtedness		Form 4952 line reference
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20
Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization: (a) ..., (b) ..., (c) ..., (d) ...		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		

Part V Property Eligible for Investment Credit				Form 3468 line reference
Basis of new investment property	(a) 3 or more but less than 5 years			line 1(a)
	(b) 5 or more but less than 7 years			line 1(b)
	(c) 7 or more years		136,000	line 1(c)
Qualified progress expenditures	(d) 7 or more years	1974, 1975, 1976, and 1977		line 1(d)
	(e) 7 or more years	1978		line 1(e)
Cost of used investment property	(f) 3 or more but less than 5 years			line 1(f)
	(g) 5 or more but less than 7 years			line 1(g)
	(h) 7 or more years			line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255.)

	(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 × column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 × column 10)
A										
B										

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Richard U. Bayles 18 Calvin Rd. Weston, CT 06883	435-56-0730	300	9-7-79	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
None	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year
beginning Dec. 26, 1978, ending Nov. 30, 1979
(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(16180)	Schedule E, Part III
2 (a) Undistributed taxable income—net long-term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II
Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		
Part III Interest on Investment Indebtedness		Form 4952 line reference
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20
Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization: (a) ..., (b) ..., (c) ..., (d) ...		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		

Part V Property Eligible for Investment Credit				Form 3468 line reference
Basis of new investment property	(a) 3 or more but less than 5 years			line 1(a)
	(b) 5 or more but less than 7 years			line 1(b)
	(c) 7 or more years		408,000	line 1(c)
Qualified progress expenditures	(d) 7 or more years	1974, 1975, 1976, and 1977		line 1(d)
	(e) 7 or more years	1978		line 1(e)
Cost of used investment property	(f) 3 or more but less than 5 years			line 1(f)
	(g) 5 or more but less than 7 years			line 1(g)
	(h) 7 or more years			line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255.)

	(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 x column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 x column 10)
A										
B										

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Warren Wilson Onion Hill Westport, CT 06880	158-20-6422	300 600	9-7-79 9-10-79	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
NONE	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year beginning Dec. 26, 1978, ending Nov. 30, 1979

(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(4093)	Schedule E, Part III
2 (a) Undistributed taxable income—net long term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II

Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		

Part III Interest on Investment Indebtedness		Form 4952 line reference
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20

Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization: (a) ....., (b) ....., (c) ....., (d)		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		

Part V Property Eligible for Investment Credit			Form 3468 line reference
Basis of new investment property	(a) 3 or more but less than 5 years		line 1(a)
	(b) 5 or more but less than 7 years		line 1(b)
	(c) 7 or more years	136,000	line 1(c)
Qualified progress expenditures	(d) 7 or more years — 1974, 1975, 1976, and 1977		line 1(d)
	(e) 7 or more years — 1978		line 1(e)
Cost of used investment property	(f) 3 or more but less than 5 years		line 1(f)
	(g) 5 or more but less than 7 years		line 1(g)
	(h) 7 or more years		line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255)

	(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 x column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 x column 10)
A										
B										

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Anthony & Daisy Colonnese JTWROS 56 Dogwood Drive Easton, CT 06612	047-16-6967 049-16-6164	300	9-29-79	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
None	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year
beginning Dec. 26, 1978, ending Nov. 30, 1979
(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(195)	Schedule E, Part III
2 (a) Undistributed taxable income—net long-term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II
Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		Form 4952 line reference
Part III Interest on Investment Indebtedness		
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20
Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization (a) ..., (b) ..., (c) ..., (d) ...		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		
Part V Property Eligible for Investment Credit		Form 3468 line reference
Basis of new investment property: (a) 3 or more but less than 5 years		line 1(a)
(b) 5 or more but less than 7 years		line 1(b)
(c) 7 or more years	408,000	line 1(c)
Qualified progress expenditures: (d) 7 or more years — 1974, 1975, 1976, and 1977		line 1(d)
(e) 7 or more years — 1978		line 1(e)
Cost of used investment property: (f) 3 or more but less than 5 years		line 1(f)
(g) 5 or more but less than 7 years		line 1(g)
(h) 7 or more years		line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255)

(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 x column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 x column 10)
A									
B									

Part VII Jobs Credits

	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Arthur L. Matschke 73 Daves Lane Southport, CT 06490	361-20-4812	900	11-30-79	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
None	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year beginning Dec. 26, 1978, ending NOV. 30, 1979

(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(65)	Schedule E, Part III
2 (a) Undistributed taxable income—net long-term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II
Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		
Part III Interest on Investment Indebtedness		Form 4952 line reference
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20
Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization: (a) ....., (b) ....., (c) ....., (d)		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		
Part V Property Eligible for Investment Credit		Form 3468 line reference
Basis of new investment property: (a) 3 or more but less than 5 years		line 1(a)
(b) 5 or more but less than 7 years		line 1(b)
(c) 7 or more years	136,000	line 1(c)
Qualified progress expenditures: (d) 7 or more years — 1974, 1975, 1976, and 1977		line 1(d)
(e) 7 or more years — 1978		line 1(e)
Cost of used investment property: (f) 3 or more but less than 5 years		line 1(f)
(g) 5 or more but less than 7 years		line 1(g)
(h) 7 or more years		line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255)

	(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 × column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 × column 10)
A										
B										

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Robert P. Frey 182 Southport Woods Rd. Southport, CT 06490	366-20-2403	300	11-30-79	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
None	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year
beginning Dec. 26, 1978, ending Nov. 30, 1979
(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form.
1 Undistributed taxable income—ordinary income or (loss)	(65)	Schedule E, Part III
2 (a) Undistributed taxable income—net long-term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II
Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		
Part III Interest on Investment Indebtedness		Form 4952 line reference
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20
Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization: (a) ....., (b) ....., (c) ....., (d)		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		
Part V Property Eligible for Investment Credit		Form 3468 line reference
Basis of new investment property: (a) 3 or more but less than 5 years		line 1(a)
(b) 5 or more but less than 7 years		line 1(b)
(c) 7 or more years	136,000	line 1(c)
Qualified progress expenditures: (d) 7 or more years — 1974, 1975, 1976, and 1977		line 1(d)
(e) 7 or more years — 1978		line 1(e)
Cost of used investment property: (f) 3 or more but less than 5 years		line 1(f)
(g) 5 or more but less than 7 years		line 1(g)
(h) 7 or more years		line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255)

(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 × column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 × column 10)
A									
B									

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Roy J. Morton 7 Highwood Lane Westport, CT 06880	411-50-0808	300	11-30-79	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
None	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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SCHEDULE K-1
(Form 1120S)

Department of the Treasury
Internal Revenue Service

Revised in Accordance with the Revenue Act of 1978 and the Energy Tax Act of 1978

Shareholder's Share of Undistributed Taxable Income, etc.—1978

For calendar year 1978 or other taxable year beginning Dec. 26, 1978, ending Dec. 30, 1979

(Complete a separate Schedule K-1 for each shareholder—See instructions on back of Copy C)

Copy A
File with
Form 1120S

Part I Income	(a) Amount	(b) Form 1040 filers enter col. (a) amount as indicated below. Form 1041 filers enter col. (a) amount on corresponding line of that form
1 Undistributed taxable income—ordinary income or (loss)	(65)	Schedule E, Part III
2 (a) Undistributed taxable income—net long-term capital gain after tax		Schedule D, Part II
(b) Portion of line 2(a) attributable to transactions after 10-31-78 (after tax)		Schedule D, Part II
Part II Losses from Section 465 Activities		
1 Shareholder's distributive share of losses from section 465 activities (see instructions)		Form 4952 line reference
Part III Interest on Investment Indebtedness		
1(a) Interest on investment indebtedness incurred prior to December 17, 1969		line 1
(b) Interest on investment indebtedness incurred prior to September 11, 1975, but after December 16, 1969		line 15
(c) Interest on investment indebtedness incurred after September 10, 1975		line 5
2 Net investment income or (loss)		line 2 or 10
3 Excess expenses from "net lease property"		line 11 and 19
4 Net capital gain attributable to investment property		line 20
Part IV Items of Tax Preference (See Instructions)		Form 4625 line reference
1 Accelerated depreciation on: (a) Low income rental housing		line 1(b)(1)
(b) Other real property		line 1(b)(2)
(c) Personal property subject to a lease		line 1(c)
2 Amortization (a) ....., (b) ....., (c) ....., (d)		line 1(d), (e), (f) and (g)
3 Reserves for losses on bad debts of financial institutions		line 1(h)
4 Depletion		line 1(j)
5 Intangible drilling costs		line 1(l)
6 Net capital gain (after tax)		

Part V Property Eligible for Investment Credit				Form 3468 line reference
Basis of new investment property	(a) 3 or more but less than 5 years			line 1(a)
	(b) 5 or more but less than 7 years			line 1(b)
	(c) 7 or more years		136,000	line 1(c)
Qualified progress expenditures	(d) 7 or more years	1974, 1975, 1976, and 1977		line 1(d)
	(e) 7 or more years	1978		line 1(e)
Cost of used investment property	(f) 3 or more but less than 5 years			line 1(f)
	(g) 5 or more but less than 7 years			line 1(g)
	(h) 7 or more years			line 1(h)

Part VI Property Used in Recomputing a Prior Year Investment Credit (Enter in corresponding column of Form 4255)

	(1) Description of property (also state whether new or used)	(2) Date placed in service	(3) Cost or basis	(4) Estimated useful life	(5) Applicable percentage	(6) Original qualified investment (column 3 × column 5)	(8) Date item ceased to be investment credit property	(9) Period actually used	(10) Applicable percentage	(11) Qualified investment (column 3 × column 10)
A										
B										

Part VII Jobs Credits	(a) Amount	Line references
1 New jobs credit		Form 5884, line 20
2 New jobs credit (combined new jobs credit and targeted jobs credit)		Form 5884-FY, line 27

Part VIII Other Information

1. Name and address of shareholder	2. Social security number	3. Stock ownership: Number of shares	Period held: Date acquired	Period held: Date of disposition
Pamela C. Bechard 462 Rock Rimmon Rd. Stamford, CT 06903	043-36-5858	300	11-30-79	

4. Compensation	5. Percentage of time devoted to business	6. Corporation's name, identifying number, and address (including ZIP code)
None	As Req.	Compo Financial Services, Ltd. 06-0993172 21 Charles Street Westport, CT 06880

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4-D

Form 872-A (Rev. September 1980)	Department of the Treasury — Internal Revenue Service **Special Consent to Extend the Time to Assess Tax**	In reply refer to: E:EP:EO SSN or EIN 06-0903172

Compo Financial Services Ltd.
(Name(s))

taxpayer(s) of 21 Charles St. Westport, CT 06880
(Number, Street, City or Town, State, ZIP Code)

and the District Director of Internal Revenue or Regional Director of Appeals consent and agree as follows:

(1) The amount(s) of any Federal Income tax due on any return(s) made by o
(Kind of tax)
for the above taxpayer(s) for the period(s) ended November 30, 1980
may be assessed on or before the 90th (ninetieth) day after: (a) the Internal Revenue Service office considering the case receives Form 872-T, Notice of Termination of Special Consent to Extend the Time to Assess Tax, from the taxpayer(s); or (b) the Internal Revenue Service mails Form 872-T to the taxpayer(s); or (c) the Internal Revenue Service mails a noti of deficiency for such period(s); except that if a notice of deficiency is sent to the taxpayer(s), the time for assessing the tax for the period(s) stated in the notice of deficiency will end 60 days after the period during which the making of an assessment was prohibited. A final adverse determination subject to declaratory judgment under sections 7428, 7476, or 7477 of the Internal Revenue Code will not terminate this agreement.

(2) This agreement ends on the earlier of the above expiration date or the assessment date of an increase in the above tax that reflects the final determination of tax and the final administrative appeals consideration. An assessment fc one period covered by this agreement will not end this agreement for any other period it covers. Some assessments do no reflect a final determination and appeals consideration and therefore will not terminate the agreement before the expiration date. Examples are assessments of: (a) tax under a partial agreement; (b) tax in jeopardy; (c) tax to correct mathematical or clerical errors; (d) tax reported on amended returns; and (e) advance payments. In addition, unassessed payments, such as amounts treated by the Service as cash bonds and advance payments not assessed by the Service, will nc terminate this agreement before the expiration date determined in (1) above. This agreement ends on the date determine in (1) above regardless of any assessment for any period includible in a report to the Joint Committee on Taxation submitted under section 6405 of the Internal Revenue Code.

(3) This agreement will not reduce the period of time otherwise provided by law for making such assessment.

(4) The taxpayer(s) may file a cliam for credit or refund and the Service may credit or refund the tax within 6 (six) months after this agreement ends.

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MAKING THIS CONSENT WILL NOT DEPRIVE THE TAXPAYER(S) OF ANY APPEAL RIGHTS TO WHICH THEY WOULD OTHERWISE BE ENTITLED.

YOUR SIGNATURE HERE → ______________________ ______________ (Date signed)

SPOUSE'S SIGNATURE → ______________________ ______________ (Date signed)

TAXPAYER'S REPRESENTATIVE SIGN HERE → ______________________ ______________ (Date signed)

CORPORATE NAME → ______________________

CORPORATE OFFICER(S) SIGN HERE → ______________________ (Title) 12/21/83 (Date signed)

→ ______________________ (Title) ______________ (Date signed)

JAMES E. QUINN
DISTRICT DIRECTOR OF INTERNAL REVENUE ______________ REGIONAL DIRECTOR OF APPEALS

BY ______________________ (Signature and Title) 12/30/83 (Date signed)

Instructions

If this consent is for income tax, self-employment tax, or FICA tax on tips and is made for any year(s) for which a joint return was filed, both husband and wife must sign the original and copy of this form unless one, acting under a power of attorney, signs as agent for the other. The signatures must match the names as they appear on the front of this form.

If this consent is for gift tax and the donor and the donor's spouse elected to have gifts to third persons considered as made one-half by each, both husband and wife must sign the original and copy of this form unless one, acting under a power of attorney, signs as agent for the other. The signatures must match the names as they appear on the front of this form.

If this consent is for Chapter 41, 42, or 43 taxes involving a partnership or is for a partnership return, only one authorized partner need sign.

If you are an attorney or agent of the taxpayer(s), you may sign this consent provided the action is specifically authorized by a power of attorney. If the power of attorney was not previously filed, please include it with this form.

If you are acting as a fiduciary *(such as executor, administrator, trustee, etc.)* and you sign this consent, attach Form 56, Notice Concerning Fiduciary Relationship, unless it was previously filed.

If the taxpayer is a corporation, sign this consent with the corporate name followed by the signature and title of the officer(s) authorized to sign.

If this consent is for Chapter 42 taxes, a separate Form 872-A should be completed for each potential disqualified person or entity that may have been involved in a taxable transaction during the related tax year. See Revenue Ruling 75-391, 1975-2 C.B. 446.

Department of the Treasury - Internal Revenue Service

Form 872-A
(Rev. September 1980)

Special Consent to Extend the Time to Assess Tax

E:E:1312:P.R.
SSN or EIN
049-32-7803

SHELDON B & PHYLLIS BUFFERD
(Name(s))

taxpayer(s) of 11 OAK LANE WESTON CT 06883
(Number, Street, City or Town, State, ZIP Code)

and the District Director of Internal Revenue or Regional Director of Appeals consent and agree as follows:

(1) The amount(s) of any Federal Income tax due on any return(s) made by o
(Kind of tax)
for the above taxpayer(s) for the period(s) ended December 31, 1979
may be assessed on or before the 90th (ninetieth) day after: (a) the Internal Revenue Service office considering the case receives Form 872-T, Notice of Termination of Special Consent to Extend the Time to Assess Tax, from the taxpayer(s); or (b) the Internal Revenue Service mails Form 872-T to the taxpayer(s); or (c) the Internal Revenue Service mails a noti of deficiency for such period(s); except that if a notice of deficiency is sent to the taxpayer(s), the time for assessing the tax for the period(s) stated in the notice of deficiency will end 60 days after the period during which the making of an assessment was prohibited. A final adverse determination subject to declaratory judgment under sections 7428, 7476, or 7477 of the Internal Revenue Code will not terminate this agreement.

(2) This agreement ends on the earlier of the above expiration date or the assessment date of an increase in the above tax that reflects the final determination of tax and the final administrative appeals consideration. An assessment f one period covered by this agreement will not end this agreement for any other period it covers. Some assessments do nc reflect a final determination and appeals consideration and therefore will not terminate the agreement before the expiration date. Examples are assessments of: (a) tax under a partial agreement; (b) tax in jeopardy; (c) tax to correct mathematical or clerical errors; (d) tax reported on amended returns; and (e) advance payments. In addition, unassessed payments, such as amounts treated by the Service as cash bonds and advance payments not assessed by the Service, will nc terminate this agreement before the expiration date determined in (1) above. This agreement ends on the date determine in (1) above regardless of any assessment for any period includible in a report to the Joint Committee on Taxation submitted under section 6405 of the Internal Revenue Code.

(3) This agreement will not reduce the period of time otherwise provided by law for making such assessment.

(4) The taxpayer(s) may file a claim for credit or refund and the Service may credit or refund the tax within 6 (six) months after this agreement ends.

(5) The amount of any deficiency assessment is to be limited to that resulting from any adjustment to: (a) the taxpayer's distributive share of any item of income, gain, loss, deduction, or credit of, or distribution from any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's tax return); (b) the tax basis of the taxpayer's interest(s) in such partnership(s) or organization(s) treated by the taxpayer as a partnership; and (c) any gain or loss (or the character or timing thereof) realized upon the sale or exchange, abandonment, or other disposition of taxpayer's interest in such partnership(s) or organization(s) treated by the taxpayer as a partnership; including any consequential changes to other items based on such adjustment.

RECEIVED
DIST DIR INT REV-HAR
MAR 15 1983
FIELD AUDIT BRANCH
AUDIT DIV.
NORWALK

55

MAKING THIS CONSENT WILL NOT DEPRIVE THE TAXPAYER(S) OF ANY APPEAL RIGHTS TO WHICH THEY WOULD OTHERWISE BE ENTITLED.

YOUR SIGNATURE HERE → Sheldon B Buffard — 3/7/83 (Date signed)

SPOUSE S SIGNATURE → Phyllis Buffard — 3/7/83 (Date signed)

TAXPAYER'S REPRESENTATIVE SIGN HERE → _____ (Date signed)

CORPORATE NAME → _____

CORPORATE OFFICER(S) SIGN HERE → _____ (Title) _____ (Date signed)

_____ (Title) _____ (Date signed)

James E. Quinn
DISTRICT DIRECTOR OF INTERNAL REVENUE

REGIONAL DIRECTOR OF APPEALS

BY Gil Gill GROUP MANAGER
(Signature and Title)

3/15/83
(Date signed)

56

Instructions

If this consent is for income tax, self-employment tax, or FICA tax on tips and is made for any year(s) for which a joint return was filed, both husband and wife must sign the original and copy of this form unless one, acting under a power of attorney, signs as agent for the other. The signatures must match the names as they appear on the front of this form.

If this consent is for gift tax and the donor and the donor's spouse elected to have gifts to third persons considered as made one-half by each, both husband and wife must sign the original and copy of this form unless one, acting under a power of attorney, signs as agent for the other. The signatures must match the names as they appear on the front of this form.

If this consent is for Chapter 41, 42, or 43 taxes involving a partnership or is for a partnership return, only one authorized partner need sign.

If you are an attorney or agent of the taxpayer(s), you may sign this consent provided the action is specifically authorized by a power of attorney. If the power of attorney was not previously filed, please include it with this form.

If you are acting as a fiduciary *(such as executor, administrator, trustee, etc.)* and you sign this consent, attach Form 56, Notice Concerning Fiduciary Relationship, unless it was previously filed.

If the taxpayer is a corporation, sign this consent with the corporate name followed by the signature and title of the officer(s) authorized to sign.

If this consent is for Chapter 42 taxes, a separate Form 872-A should be completed for each potential disqualified person or entity that may have been involved in a taxable transaction during the related tax year. See Revenue Ruling 75-391, 1975-2 C.B. 446.

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T.C. Memo. 1991-170

UNITED STATES TAX COURT

SHELDON B. BUFFERD AND PHYLLIS BUFFERD,
Petitioners v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 3970-88. Filed April 15, 1991.

We are bound to follow our Court-reviewed opinion in *Fehlhaber v. Commissioner*, 94 T.C. 863 (1990). *Held*: The notice of deficiency mailed to petitioners on December 4, 1987, was timely under section 6501(a) and, therefore, the assessment is not barred by the statute of limitations.

MEMORANDUM FINDINGS OF FACT AND OPINION

WHITAKER, *Judge*: Respondent determined deficiencies and additions to tax in petitioners' Federal income tax as follows:

Year	Deficiency	Addition to Tax Section 6653(a)[1]
1975	$ 3,069	$153.45
1976	3,704	185.20
1977	6,291	314.55
1978	13,859	692.95
1979	12,555	627.75

[1] Unless otherwise noted, all section references are to the Internal Revenue Code of 1954 as amended and in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

After concessions, the sole issue for decision is whether the statute of limitations relating to the assessment of an income tax deficiency determined against the shareholder of a subchapter S corporation is to be measured at the corporate level or at the shareholder level. We are bound to follow our Court-reviewed opinion in *Fehlhaber v. Commissioner,* 94 T.C. 863 (1990). Therefore, we hold that the notice of deficiency mailed to petitioners on December 4, 1987, was timely under section 6501(a) and the assessment is not barred by the statute of limitations.

FINDINGS OF FACT

This case was submitted for decision under Rule 122. The stipulations and attached exhibits are incorporated herein by this reference.

Petitioner, Sheldon B. Bufferd, resided in Fairfield, Connecticut, at the time the petition was filed. Petitioner, Phyllis Bufferd, resided in Westport, Connecticut, at the time the petition was filed.

The concessions in this case are as follows: (1) For the 1978 taxable year, petitioner is entitled to an ordinary deduction in the amount of $20,000 which is equal to his cash investment in Printer Associates; (2) petitioner is not entitled to any other losses or credits attributable to Printer Associates for any year; (3) Mrs. Bufferd is not liable for any deficiencies for the taxable years 1975 through 1979 pursuant to section 6013(e); (4) Mrs. Bufferd is not liable for additions to tax for the taxable years 1975 through 1979 under sections 6653(a) and 6659 pursuant to section 6013(e); (5) Mrs. Bufferd is not liable for the

increased rate of interest under section 6621(c) for the taxable years 1975 through 1979 pursuant to section 6013(e); (6) Mr. Bufferd is not liable for additions to tax for the taxable years 1975 through 1979 under sections 6653(a) and 6659, and (7) Mr. Bufferd is liable for the increased rate of interest under section 6621(c) for the taxable years 1975 through 1979.

The facts that are relevant to the statute of limitation issue remaining is this case are as follows. In 1979 Mr. Bufferd (hereinafter petitioner) was a shareholder in Compo Financial Services, Ltd. (Compo). In 1979 Compo was an electing small business corporation within the meaning of section 1371(a). Compo timely filed a U.S. Small Business Corporation Income Tax Return (Form 1120S) for the taxable period December 26, 1978, through November 30, 1979, on February 1, 1980. Compo did not extend the statute of limitations for assessment of taxes as provided under section 6501(c)(4) with respect to its taxable period ended November 30, 1979. On December 21, 1983, petitioner, in his capacity as secretary/treasurer of Compo executed a Special Consent to Extend the Time to Assess Tax (Form 872-A) with respect to the taxable period ended November 30, 1980. On December 15, 1987, respondent executed a Notice of Termination of Special Consent to Extend the Time to Assess Tax (Form 872-T) with respect to Form 872-A dated July 22, 1985, executed by the parties with respect to Compo's taxable period ended November 30, 1982.

On April 15, 1980, petitioners filed their Federal income tax return for the 1979 taxable year. Petitioners reported their income and deductions for the 1979 taxable year on the basis of cash receipts and disbursements. On

petitioners' 1979 tax return, they claimed an ordinary loss in the total amount of $11,550 ($11,050 with respect to Printer Associates and $500 with respect to Compo). On petitioners' 1979 tax return, they also claimed an investment credit with respect to Compo in the amount of $8,023.

On March 7, 1983, petitioners timely executed a Form 872-A for their 1979 taxable year. Respondent executed Form 872-A on March 15, 1983. Neither petitioners nor respondent filed a Form 872-T with respect to petitioners' 1979 taxable year.

In the statutory notice of deficiency dated December 4, 1987, respondent disallowed petitioners' claimed 1979 loss and investment credit attributable to Compo for its taxable period December 26, 1978, through November 30, 1979. Respondent further determined that petitioner's distributive share of Compo income in 1979 was $1,418, resulting in a total adjustment with respect to Compo in the amount of $1,918. The statutory notice was timely sent to petitioners prior to the expiration of the 3-year period for assessment with respect to petitioners' 1979 tax return, as duly and timely extended under Form 872-A. The statutory notice was issued to petitioners more than 3 years after the filing of Compo's Form 1120S for the taxable period ended November 30, 1979, for which an extension of the assessment period was not executed by the corporation.

OPINION

This issue was previously considered by this Court in *Kelley v. Commissioner*, T.C. Memo. 1986-405. In *Kelley*, this

Court held that the statute of limitations on assessment of a deficiency resulting from the disallowance of a loss flow-through from a subchapter S corporation is measured with reference to the individual shareholder's income tax return, rather than the corporation's information return. This Court's decision in *Kelly* was subsequently reversed in *Kelly v. Commissioner*, 877 F.2d 756 (9th Cir. 1989). In *Fehlhaber v. Commissioner*, 94 T.C. 863 (1990), we reconsidered our opinion in *Kelley*, in view of the reversal by the United States Court of Appeals for the Ninth Circuit. In *Fehlhaber*, we concluded that our holding in *Kelley* was correct and, therefore, we would adhere to our conclusion reached in *Kelley*. In *Fehlhaber*, we respectfully declined to follow the decision of the Court of Appeals for the Ninth Circuit on this issue where the appeal lies to another circuit. See *Golsen v. Commissioner*, 54 T.C. 742, 756-757 (1970), affd. 445 F.2d 985 (10th Cir. 1971). The appeal in this case lies in the Second Circuit. Therefore, we are bound to follow our Court-reviewed opinion in *Fehlhaber*. Accordingly, we hold that the notice of deficiency mailed to petitioners on December 4, 1987, was timely under section 6501(a) and, therefore, the assessment is not barred by the statute of limitations.

Decision will be entered under Rule 155.

UNITED STATES TAX COURT

SHELDON B. BUFFERD and PHYLLIS BUFFERD, Petitioners, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	Docket No. 3970-88

DECISION

Pursuant to the opinion of the Court filed on April 15, 1991, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income tax due from the petitioners, before application of I.R.C. § 6013(e), as follows:

Deficiencies

Year	Income Tax	Additions I.R.C. § 6653(a)	Additions I.R.C. § 6659
1975	$ 3,069.00	- 0 -	- 0 -
1976	3,704.00	- 0 -	- 0 -
1977	6,291.00	- 0 -	- 0 -
1978	4,251.00	- 0 -	- 0 -
1979	12,555.00	- 0 -	- 0 -

That, before application of I.R.C. § 6013(e), the entire deficiency in income tax due from the petitioners for each of the taxable years 1975, 1976, 1977, 1978 and 1979 is a substantial underpayment attributable to tax motivated

transactions for purposes of computing the interest payable pursuant to I.R.C. § 6621(c).

That the foregoing deficiencies are due from the petitioners under the provisions of I.R.C. § 6013(e) as follows:

Joint Liability

Year	Income Tax	Additions I.R.C. § 6653(a)	Additions I.R.C. § 6659
1975	- 0 -	- 0 -	- 0 -
1976	- 0 -	- 0 -	- 0 -
1977	- 0 -	- 0 -	- 0 -
1978	- 0 -	- 0 -	- 0 -
1979	- 0 -	- 0 -	- 0 -

Additional Amounts Due From Sheldon B. Bufferd

Year	Income Tax	Additions I.R.C. § 6653(a)	Additions I.R.C. § 6659
1975	$ 3,069.00	- 0 -	- 0 -
1976	3,704.00	- 0 -	- 0 -
1977	6,291.00	- 0 -	- 0 -
1978	4,251.00	- 0 -	- 0 -
1979	12,555.00	- 0 -	- 0 -

That the entire deficiency in income tax due from the petitioner, Sheldon B. Bufferd, for each of the taxable years 1975, 1976, 1977, 1978 and 1979 is a substantial underpayment attributable to tax motivated transactions

for purposes of computing the interest payable pursuant to I.R.C. § 6621(c).

(Signed) Meade Whitaker

Judge

Entered: MAY 14 1991

* * *

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

ABRAHAM N. M. SHASHY, JR.
Chief Counsel
Internal Revenue Service

By: **(Signed) Bradford A. Johnson**
BRADFORD A. JOHNSON
Assistant District Counsel
Tax Court No. JB0034
Commerce Center One
333 East River Drive
Suite 200
East Hartford, CT 06108
Tel. No. (203) 528-1563
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/s/ Stuart J. Filler
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/s/ Mary Ferrari
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Counsel for Petitioner,
Phyllis Bufferd
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School of Law
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Room 409
Bridgeport, CT 06601
Tel. No. (203) 576-4073

Date: 5-8-91

Date: MAY 10 1991

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 214 – August Term, 1991

(Argued September 25, 1991
Decided January 3, 1992)

Docket No. 91-4099

SHELDON B. BUFFERD; PHYLLIS BUFFERD,

Petitioners-Appellants,

– v. –

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Before:

MESKILL, WINTER and ALTIMARI,

Circuit Judges.

Appeal from a decision by the United States Tax Court determining that the Commissioner of Internal Revenue timely assessed a deficiency on petitioner's individual income tax payment arising from his distributive share in the income of an S corporation.

Affirmed.

MESKILL, *Circuit Judge:*

Sheldon Bufferd appeals from a decision of the United States Tax Court imposing a tax deficiency on him for the year 1979. The sole issue on appeal is whether the Commissioner of Internal Revenue (Commissioner) timely assessed the deficiency. The tax court held that the Commissioner was not barred by the limitation provision of the Internal Revenue Code.

We affirm.

BACKGROUND

In 1979 Sheldon B. Bufferd was a shareholder in Compo Financial Services, Inc., an electing small business corporation under Subchapter S of the Internal Revenue Code. 26 U.S.C. § 1371 *et seq.* (1954 Act) (unless otherwise noted, all references are to the Internal Revenue Code of 1954 as amended and effective during the years in issue). Bufferd and Compo were two of several partners in a venture known as Printer's Associates (Printer's). Printer's reported substantial losses in 1979 arising from a failed investment in a new technology. Compo reported a loss from the Printer's partnership on its 1979 small business corporation income tax return. Bufferd and his wife filed a joint income tax return in 1979. In that return they reported a loss from the Printer's partnership. The Bufferds also reported their distributive share of Compo's loss on their 1979 return.

In March 1983 the Bufferds and a representative of the Commissioner executed a form entitled "Special Consent to Extend the Time to Assess Tax" (Form 872-A). The

document provided that, regardless of the statute of limitations, the Commissioner could assess income tax due on the Bufferds' 1979 return at any time prior to ninety days after revocation of the consent by the Bufferds. The document contained a proviso limiting any such deficiency assessment to that resulting from adjustments to the Bufferds' distributive share from, basis in or sale of any interest in "any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's return)." The Bufferds never revoked the consent to the extension of time. Compo never assented to an extension of time to assess the tax due for 1979.

The Commissioner subsequently determined that the losses reported by Printer's were improper. The Commissioner thus made adjustments to the Bufferds' 1979 return by disallowing the partnership loss. The Commissioner also adjusted Compo's return to reflect the disallowance of Printer's losses. Bufferd's distributive share from Compo was thus altered from a $500 loss to a $1,418 gain. Bufferd's wife settled separately with the Commissioner following her divorce from petitioner. Bufferd ultimately agreed to the deficiency assessed by the Commissioner to the extent of the disallowance of the direct partnership loss. Bufferd argued, however, that the Commissioner could not assess a deficiency with regard to the Compo adjustment because the statute of limitations had run with respect to Compo's tax liability.

The tax court determined that the Form 872-A executed by petitioner defeated Bufferd's statute of limitations defense. Thus the tax court ordered Bufferd to pay the full amount of the deficiency. Bufferd appeals that decision.

DISCUSSION

Bufferd contends that the Commissioner could not properly have made any adjustments to his return that result from adjustments to Compo's return because the limitations period with respect to Compo had expired and no extension of that period had been executed. The commissioner urges that we affirm the tax court, which held that the relevant limitations period for purposes of assessing the tax due on the Bufferds' 1979 joint return was the period directly associated with that return. We agree with the Commissioner and the tax court on this point.

26 U.S.C.§ 6501(a) provides the limitations period for the assessment of taxes. That section provides in pertinent part that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed." An exception to this limitations period is provided where the Secretary and the taxpayer consent in writing to an extension of time. 26 U.S.C. § 6501(c)(4).

At the heart of this dispute is the meaning of the word "return" in section 6501(a). The Commissioner claims that that term refers to the return of the taxpayer against whom the Commissioner has imposed the deficiency. Bufferd claims that, in the context of a gain or loss resulting from an adjustment to the return of an S corporation, the return of the S corporation is the relevant return.

We recently addressed the meaning of "return" in section 6501(a). In *Siben v. C.I.R.*, 930 F.2d 1034 (2d Cir. 1991), *cert. denied*, 112 S.Ct. 429 (1991), the Commissioner

had made an adjustment to an individual partner's return based on alterations to the partnership return. The taxpayer argued that because the statute of limitations had run with respect to the partnership, the Commissioner was barred from adjusting the individual partner's distributive share of the partnership's income. We stated that

> It appears to us that the "return" that starts the running of the limitations period at issue is that of the taxpayer whose liability is being assessed, and not that of a third person or entity whose return might also report the transaction that gives rise to the liability. On this reading, the return referred to in § 6501(a) would thus be the individual's income tax return for an assessment of individual income tax.

Id. at 1035.

Bufferd argues that because the "third person or entity" at issue here is an S corporation rather than a partnership, *Siben* is inapplicable. Bufferd points to 26 U.S.C. § 6037, which states in pertinent part that a return filed by an S corporation "shall, for purposes of chapter 66, (relating to limitations) [and containing section 6501(a)], be treated as a return filed by the corporation under section 6012." The statute that requires partnerships to file returns, 26 U.S.C. § 6031, has no similar provision relating to the effect of those returns on the limitations period.

Bufferd urges that in interpreting the effect of section 6037 on section 6501(a) we adopt the reasoning of *Kelley v. C.I.R.*, 877 F.2d 756 (9th Cir. 1989). In *Kelley* the Ninth Circuit held that those sections bar the Commissioner

from adjusting a shareholder's return based on an adjustment to an S corporation's return when the limitations period has run on the S corporation's return. *Id.* at 759. The court noted that section 6501 barred any adjustments to corporate returns after the limitations period. Section 6037 mandates that S corporation returns be treated as corporate returns for purposes of limitations. Therefore, reasoned the *Kelley* Court, returns of S corporations could not be adjusted in any way after the limitations period had run.

We disagree with *Kelley's* interpretation of section 6501(a). That section bars only the assessment of a tax on an entity more than three years after the entity has filed a return. Section 6501(a) does not bar adjustments to an entity's return that do not result in a tax assessment on that entity. An adjustment to the return of an S corporation that does not impose tax liability on that S corporation is not barred by sections 6501(a) and 6037.

Bufferd argues that if we do not interpret section 6037 as he proposes we will effectively eliminate that section from the statute. We disagree. Section 6037 provides the limitations period for organizations that file returns as S corporations but are nonetheless required to pay some tax on the organization's income. For example, if an organization was not entitled to elect to become an S corporation, any tax on the organization's income as a normal corporation must be assessed within three years of the filing of the S corporation return. *Fehlhaber v. C.I.R.*, 94 T.C. 863 (1990) (quoting S. Rep. No. 1983, 85th Cong. 2nd Sess. (1958), 1958-3 C.B. 922, 1147). In this respect the final phrase in section 6037 performs for S corporations a function similar to that performed by section 6501(g) for

trusts, exempt organizations and Domestic International Sales Corporations.

Moreover, valid S corporations on occasion are required to pay tax on certain types of income. *See* 26 U.S.C. § 1374 (imposing tax on certain capital gains by S corporations). Section 6037 provides that in such cases the filing of an S corporation return triggers the limitations period for imposition of this direct tax against the S corporation. Section 6037 therefore retains ample meaning even bereft of the interpretation proposed by Bufferd.

Bufferd also argues that if the limitations period of the S corporation does not govern the assessment of tax on a shareholder's distributive share derived from that S corporation, the taxpayer will be unable to defend itself effectively against any deficiency imposed by the Commissioner. Bufferd argues that the S corporation could destroy the books and records necessary for such a defense after its limitations period had passed. In *Siben* we held that "a taxpayer can generally protect himself by taking steps to ensure that the partnership preserves records needed to support the partnership item claimed on the individual partner's return." 930 F.2d at 1037. We believe that a shareholder of an S corporation can take similar protective steps with regard to the S corporation records needed to support the S corporation items claimed on the shareholder's return.

We find the words of section 6501(a) clear and unambiguous. Barring an exception, if the Commissioner wishes to assess a tax on an entity, he must do so within three years after the filing by that entity of the return on which the tax should have been reported. We do not

believe that Section 6037 can fairly be read in the manner proposed by Bufferd.

The relevant return for purposes of section 6501(a) is Bufferd's joint return rather than Compo's S corporation return. The Form 872-A executed in March 1983 by the Bufferds gave the Commissioner the power to assess income tax due on the Bufferds' 1979 return any time prior to ninety days after Bufferd terminated the consent. The printed form also contains a typewritten proviso that limits any deficiency assessment to that resulting from adjustment to the Bufferds' distributive share from, basis in, or sale of any interest in "any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's return)."[1]

Compo Financial Services, Incorporated, was not a partnership and Bufferd did not treat it as a partnership

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[1] The entire proviso states:

> (5) The amount of any deficiency assessment is to be limited to that resulting from any adjustment to: (a) the taxpayer's distributive share of any item of income, gain, loss, deduction, or credit of, or distribution from *any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's tax return)*; (b) the tax basis of the taxpayer's interest(s) in such partnership(s) or organization(s) treated by the taxpayer as a partnership; and (c) any gain or loss (or the character or timing thereof) realized upon the sale or exchange, abandonment, or other disposition of taxpayer's interest in such partnership(s) or organization(s) treated by the taxpayer as a partnership; including any consequential changes to other items based on such adjustment.

(emphasis added).

on his 1979 joint return. The extension granted the Commissioner by Bufferd does not by its terms reach the assessment of taxes resulting from an adjustment to Buffer's distributive share from Compo.

However, Bufferd did not raise this theory before the tax court. In fact, Bufferd arguably waived this argument through the stipulations filed before the tax court. Because of these considerations, and because Bufferd did not press this argument on appeal, even after a request for additional briefing on the issue by this Court, we do not reach that issue. We consider the extension applicable to the income at issue here.

CONCLUSION

We agree with the tax court that the relevant return for purposes of determining the statute of limitations is the return of the taxpayer against whom the tax is sought. We therefore affirm the judgment of the tax court.

Supreme Court of the United States

No. 91-7804

Sheldon B. Bufferd,

Petitioner

v.

Commissioner of Internal Revenue

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

On Consideration of the motion for leave to proceed herein in forma pauperis and of the petition for writ of certiorari, it is ordered by this Court that the motion to proceed in forma pauperis be, and the same is hereby, granted; and that the petition for writ of certiorari be, and the same is hereby, granted.

June 22, 1992

No. 91-7804

In The

Supreme Court of the United States

October Term, 1992

SHELDON B. BUFFERD,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Second Circuit

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QUESTION PRESENTED

Whether the statute of limitations bars adjustments to Petitioner's income tax return with respect to items arising from an S corporation's income tax return?

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The opinion of the Court of Appeals [Joint Appendix (hereinafter "J.A.") 66] is reported at 952 F.2d 675 (2d Cir. 1992). The memorandum opinion of the Tax Court (J.A. 62) is unofficially reported at 61 T.C.M. (CCH) 2410 (1991).

JURISDICTION

The judgment of the Court of Appeals was entered on January 3, 1992. The petition for writ of certiorari was filed on March 31, 1992, and was granted on June 22, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. section 1254(1).

STATUTORY PROVISIONS INVOLVED

Internal Revenue Code section 6501(a) (1979):

> (a) General rule.-Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) . . . and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

Internal Revenue Code section 6037 (1979):

> Every electing small business corporation (as defined in section 1371(a)(2)) shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, the names and addresses of all persons owning stock in the corporation at any time during the taxable year, the number of shares of stock owned by each shareholder at all times during the taxable year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, and such other information, for the purpose of carrying out the provisions of subchapter S of chapter 1, as the Secretary or his delegate may

by forms and regulations prescribe. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.

Internal Revenue Code section 6012(a)(2) (1979):

(a) General Rule.-Returns with respect to income taxes under subtitle A shall be made by the following: . . .

(2) Every corporation subject to taxation under subtitle A; . . . .

Internal Revenue Code section 6031 (1979):

Every partnership (as defined in section 761(a)) shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, and such other information for the purpose of carrying out the provisions of subtitle A as the Secretary may by forms and regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the taxable income if distributed and the amount of the distributive share of each individual.

Internal Revenue Code section 1373(b) (1979):

(b) Amount included in gross income.-Each person who is a shareholder of an electing small business corporation on the last day of a taxable year of such corporation shall include in his gross income, for his taxable year in which or with which the taxable year of the corporation ends, the amount he would have received as a dividend, if on such last day there had been distributed pro rata to its shareholders by such corporation an amount equal to the corporation's undistributed taxable income for the corporation's taxable year. For purposes of this chapter, the amount so included shall be treated as an amount distributed as a dividend on the last day of the taxable year of the corporation.

Internal Revenue Code section 1378(a) (1979):

(a) General rule.-If for a taxable year of an electing small business corporation –

(1) the net capital gain of such corporation exceeds $25,000, and exceeds 50 percent of its taxable income for such year, and

(2) the taxable income of such corporation for such year exceeds $25,000, there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation.

STATEMENT

In 1979, the tax year at issue, Petitioner[1] was a shareholder in Compo Financial Services, Inc. (hereinafter "Compo"), which qualified as an electing small business corporation (hereinafter "S corporation") under subchapter S of the Internal Revenue Code (hereinafter "Code") 26 U.S.C. section 1371 *et seq.*[2] J.A. 37. Compo held an interest in a partnership, Printer's Associates. J.A. 40.

On February 1, 1980, Compo filed a timely United States Small Business Corporation Income Tax Return (hereinafter "Form 1120S") for the period ended November 30, 1979. J.A. 38. On its corporate return, Compo claimed its share, as a partner, of the Printer's Associates' losses and tax credits. J.A. 37-41. Petitioner timely filed his federal income tax return for 1979 on April 15, 1980. J.A. 19. Petitioner, as a shareholder in Compo, included on his 1979 income tax return a pro rata portion of the losses and tax credits reported by Compo on its income tax return for the fiscal year ended November 30, 1979. J.A. 26 and 29.

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[1] Petitioner filed a joint return for 1979 with Phyllis Bufferd, to whom Petitioner was then married. Although Phyllis Bufferd, as well as Petitioner, were parties to the proceedings below, Phyllis Bufferd has entered into a settlement with the Internal Revenue Service. J.A. 13, which was accepted by the Tax Court, J.A. 58, and is no longer a party to this case.

[2] Unless otherwise indicated, all section references in this brief are to the Internal Revenue Code of 1954, 26 U.S.C. §1 *et. seq.*, as in effect for 1979, the year at issue.

The Commissioner normally must assess tax deficiencies within three years after the filing of a return. Section 6501(a). In the past, the Internal Revenue Service (hereinafter "Service") has sought and obtained an extension of this period from S corporations. In this case, however, the government did not seek an extension for the fiscal year ending November 30, 1979. J.A. 14. It did seek and obtain an extension from Compo for the fiscal year ending November 30, 1980, and from Petitioner for his tax year 1979. J.A. 53. In March 1983, Petitioner and Respondent entered into a restricted "Special Consent to Extend the Time to Assess Tax" (hereinafter "Form 872-A"), extending the period for assessing tax due on Petitioner's individual 1979 income tax return until ninety days after such time as Petitioner or Respondent would choose to revoke the extension. The Special Consent was limited by its terms to deficiencies arising from items relating to his interest in a partnership or an organization treated by Petitioner as a partnership on his income tax return. J.A. 55.

In 1987, Respondent determined that the activities of Printer's Associates had not given rise to deductible losses or tax credits. Although more than three years had elapsed since Compo had filed its Form 1120S and Respondent had not obtained an extension of the regular limitations period from Compo, Respondent disallowed most of the losses and all of the tax credits that Compo had reported in its capacity as a partner in Printer's Associates. J.A. 14. On December 15, 1987, pursuant to this adjustment, Respondent issued a Statutory Notice of Deficiency with respect to Petitioner's 1979 income tax return disallowing the losses and tax credits that Petitioner had reported as a shareholder in Compo based on the losses and tax credits that had been reported on Compo's income tax return.

On February 25, 1988, Petitioner filed a Petition in the United States Tax Court (hereinafter "Tax Court") challenging the disallowance of the S corporation items. J.A. 8. Petitioner sought a determination that, to the extent the deficiency resulted from adjustments made to the losses and tax credits that Compo had reported on its S corporation income tax

return, Respondent's Statutory Notice of Deficiency was time-barred by the statute of limitations.

On March 19, 1990, the case was submitted on a Joint Motion to Submit Case Under Rule 122. All facts were agreed to by both parties in a Stipulation of Facts (J.A. 12-16), and a Second Stipulation of Facts with Exhibits 1A through 7G attached (J.A. 17). On May 14, 1991, the Tax Court entered a decision, T.C. Memo. 1991-170, reported unofficially at 61 T.C.M. (CCH) 2410 (1991).

In its memorandum opinion, the Tax Court noted that it had held recently in *Kelley v. Commissioner,* 52 T.C.M. 313 (CCH) (1986), that the period of limitations for assessing a deficiency resulting from the disallowance of a loss or tax credit from a subchapter S corporation was measured by reference to the shareholder's, and not the corporation's, income tax return. J.A. 57. The Tax Court acknowledged that the Court of Appeals for the Ninth Circuit had reversed its opinion in Kelley. (*Kelley v. Commissioner,* 877 F.2d 756 (1989)). J.A. 61. Nonetheless, the Tax Court adhered to its original position and adopted as its opinion in this case its opinion in *Fehlhaber v. Commissioner,* 94 T.C. 863 (1990). J.A. 57.

Petitioner appealed to the United States Court of Appeals for the Second Circuit which entered a judgment on January 3, 1992, in favor of the Respondent. The Second Circuit viewed the issue here as governed by its previous decision in *Siben v. Commissioner,* 930 F.2d 1034 (1991), *cert. denied,* ___ U.S. ___, 112 S.Ct. 429 (1991), in which the court had determined that a deficiency assessment against a partner, related to an item reported by a partnership, was not barred by any limitations period applicable to the partnership's return. J.A. 70. The court concluded that its holding in *Siben* applied to S corporations as well as partnerships. The court rejected Petitioner's argument that in enacting 6037(a), Congress had established rules for S corporation income tax returns that differed from those applicable to partnerships. J.A. 72.

Petitioner submitted his petition for writ of certiorari to this Court on March 31, 1992, which this Court granted on June 22, 1992, due, *inter alia*, to a split among the circuits.[3]

SUMMARY OF ARGUMENT

This case requires this Court to interpret the clear and unambiguous language of three interdependent sections of the Code: sections 6012(a)(2), 6501(a), and 6037(a).

Section 6012 sets forth the general requirement for filing a "return." Section 6012(a)(1), for example, requires returns from individuals earning more than certain minimum amounts of income during the year, and section 6012(a)(2) requires returns from "[e]very corporation subject to taxation under subtitle A." Section 6501(a) of the Code contains the basic rule governing limitations on assessments. It provides generally that the government may assess a deficiency "within three years after the return was filed." The statute thus places considerable emphasis on the identification of the "return" in section 6501(a).

The first sentence of section 6037(a) requires every S corporation to file annually an income tax return. The second sentence of section 6037(a) provides that this return shall be treated as a return required by section 6012 for purposes of the statute of limitations. The second sentence of section 6037(a) makes the S corporation's income tax return the "return" that begins the running of the period of limitations under section 6501(a). Therefore, it is only within the three-year period set forth in section 6501(a) that the Service or the S corporation may adjust items of income, deduction, or tax credit with respect to the S corporation's income tax return.

The Second Circuit concluded that it is the filing of the income tax return of the S corporation's shareholder rather

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[3] The Second Circuit's opinion conflicts with the opinion of the Court of Appeals for the Ninth Circuit in *Kelley v. Commissioner*, 877 F.2d 756 (1989). The Second Circuit's opinion was followed by the Eleventh Circuit in *Fehlhaber v. Commissioner*, 954 F.2d 653 (1992), and the Fifth Circuit in *Green v. Commissioner*, 963 F.2d 783 (1992).

than the S corporation's income tax return that begins the running of the period of limitations. There is no support for this interpretation in the statutory language or its legislative history. In fact, the interpretation afforded these statutes by the Second Circuit is contrary to the plain language of section 6012(a)(2) and the second sentence of section 6037(a) and renders both these sections mere surplusage.

Congress enacted section 6037 in 1958 at a time when there was no tax to be assessed against an S corporation and the second sentence of section 6037 manifests Congress' intent that, for purposes of the period of limitations, the filing date of the S corporation's income tax return, not the S corporation shareholder's income tax return, begins the running of the period of limitations with respect to S corporation items. The statutory language is unconditional and applies whether or not there is a tax imposed on the S corporation in any taxable year.

When the language of the statute is clear and unambiguous, and affords a cohesive and consistent treatment to the statutory scheme, the function of the court is to interpret the statute in accordance with its terms. The Second Circuit did not interpret the statute in accordance with its terms and, effectively, repeals section 6012(a)(2) and the second sentence of section 6037(a).

The Second Circuit ignored the plain meaning of these three Code provisions and turned to the legislative history. It misconstrued an example in the Committee Report promulgated in 1958 to accompany newly-enacted section 6037(a). The Second Circuit's analysis allowed the example to become the entire rule. Based upon this misinterpretation, the Second Circuit concluded that the return referred to in section 6501(a) is the income tax return of the shareholder of an S corporation because it is the only return upon which a tax can be assessed.

The language of the Code as well as its legislative history clearly provide that the date of the filing of the S corporation's income tax return is the beginning date for determining the limitations period for adjusting both the S corporation's

income tax return and the S corporation shareholder's income tax return, with respect to S corporation items of income, deduction, or credit. This Court must reverse the decision of the Second Circuit.

I

THE STATUTE OF LIMITATIONS BARS ADJUSTMENTS TO PETITIONER'S INCOME TAX RETURN WITH RESPECT TO ITEMS ARISING FROM AN S CORPORATION'S INCOME TAX RETURN.

A. PETITIONER'S AGREEMENT TO EXTEND THE PERIOD OF LIMITATIONS DID NOT INCLUDE S CORPORATION ITEMS.

Petitioner's agreement to extend the statute of limitations for 1979 was restricted by its terms to items arising from his ownership of an interest in a partnership or any organization treated by him as a partnership. J.A. 55. The Form 872-A executed by Petitioner and Respondent extends the normal three-year statute of limitations only with respect to the Petitioner's tax basis in, and distributive share, gain, or loss from, such entities. It does not cover items related to any other type of entity.[4] Compo was an S corporation and Petitioner treated it as such on his tax return. J.A. 32. Because Compo was not a partnership or an organization treated by Petitioner as a partnership, Form 872-A did not extend the period of limitations with respect to items arising from Petitioner's interest in Compo. *See, e.g., Goldberg v. Commissioner,* 63 T.C.M. 2168 (CCH) (1992); *Bauer v. Commissioner,* 63 T.C.M. 2921 (CCH) (1992). *Compare, Press v. Commissioner,* 52 T.C.M. 285 (CCH) (1986).

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[4] The statute of limitations has always been an issue in this case. The legal effect of Form 872-A is within the scope of both the affirmative defense of the statute of limitations properly pled by the Petitioner at the Tax Court and the questions presented to both the Second Circuit and this Court.

B. SECTIONS 6501(a), 6012(a)(2), AND 6037(a) OF THE INTERNAL REVENUE CODE REQUIRE THE CONCLUSION THAT THE FILING OF AN S CORPORATION'S INCOME TAX RETURN BEGINS THE PERIOD OF LIMITATIONS WITH RESPECT TO S CORPORATION ITEMS.

This case concerns the confluence of three sections of the Code: sections 6501(a), 6012(a)(2), and 6037(a).

Section 6501(a) provides a three-year limitations period from the date of filing a return for the Service to adjust items contained in the return and to assess any tax imposed by the Code with respect to that return.[5] In relevant portion, section 6501(a) provides that "the amount of any tax imposed by this title shall be assessed within three years after *the return* was filed . . . " (emphasis added).

Section 6012 requires certain persons[6] to file tax returns. Section 6012(a)(2) provides that "[e]very corporation subject to taxation under subtitle A" shall file a tax return. Section 6012(a)(2) is the only paragraph of section 6012 that requires a corporation to file a tax return. That paragraph does not distinguish between S and C corporations.[7]

The first sentence of section 6037(a) requires that "[e]very electing small business corporation . . . shall make a return for each taxable year . . . " and states what the S corporation must include in its income tax return. The second

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[5] Prior to 1966, S corporations were not taxable entities. Nevertheless, since enactment of subchapter S in 1958, section 6037(a) has required all S corporations to file annual income tax returns.

[6] Section 7701(a)(1) defines persons for purposes of the Code to include corporations.

[7] Corporations are taxed under two separate subchapters of the Code. Most corporations are taxed under subchapter C of the Code and are referred to as "C corporations." Subchapter S sets forth rules that permit certain corporations referred to as "S corporations" to be taxed in a special manner. A corporation must elect to be taxed under subchapter S. Prior to substantial changes effected by the Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669, corporations electing to be taxed under subchapter S were referred to as subchapter S corporations. After the 1982 Revision Act changes, such corporations are now referred to as S corporations. For convenience, this brief uses the phrase "S corporations" throughout.

sentence of section 6037(a) provides that "*[a]ny return* filed pursuant to this section *shall*, for purposes of chapter 66 (relating to limitations), *be treated as a return filed by the corporation under section 6012*" (emphasis added)[8].

Statutory interpretation begins with an analysis of the statute's language. This Court stated in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989):

> The task of resolving the dispute over the meaning of §506(b) begins where all such inquiries must begin: with the language of the statute itself. . . . In this case it is also where the inquiry should end, for where, as here, the statute's language is plain, "the sole function of the courts is to enforce it according to its terms." *Caminetti v. United States*, 242 U.S. 470, 485 . . . (1917). 489 U.S. at 241.

See also, Cippolone v. Liggett Group, Inc., ___ U.S. ___, 112 S.Ct. 2608, 2625 (1992), citing *FMC Corp. v. Holiday*, ___ U.S. ___, 111 S.Ct. 403, 407 (1990), quoting *Park 'N Fly, Inc. v. Dollar Park and Fly, Inc.*, 469 U.S. 189, 194 (1985); *Toibb v. Radloff*, ___ U.S. ___, 111 S.Ct. 2197, 2200 (1991), quoting *Blum v. Stenson*, 465 U.S. 886, 896 (1984); *Patterson v. Shumate*, ___ U.S. ___, 112 S.Ct. 2242, 2248 (1992), quoting *Toibb v. Radloff*, 111 S.Ct. at 2200, and citing *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. at 247, and *Ex parte Collett*, 337 U.S. 55, 61 (1949).

The language of sections 6501(a), 6012(a)(2), and 6037(a) is clear and unambiguous. These three sections, read together, provide that for the purpose of the statute of limitations, the date an S corporation files its income tax return (Form 1120S) is the beginning date for determining the period of limitations for adjusting items on the S corporation's

[8] Chapter 66 of subtitle F of the Code (sections 6501-6553) provides rules for limitations on assessment and collection of taxes, limitations on credit or refund, mitigation of effect of period of limitations, and periods of limitation in judicial proceedings.

income tax return and assessing any tax as a result of those adjustments.[9]

Section 6501(a) provides a three-year period of time from the date of filing a "return" during which the Service may adjust any items on that filed "return" and assess a tax imposed by the Code with respect to that "return." If, within the period of limitations on that "return," the Service concludes that adjustments should be made to that "return," it may assess a tax imposed by the Code on either (1) the person who filed that "return," or (2) on another related person to the extent that the related person's income tax return is based on that "return" and the period of limitations on the related person's income tax return is also open. Therefore, when an individual taxpayer files his or her return, the Service has three years to examine the return and assess any deficiency. When a corporation files its return, the Service has three years to examine the return and assess any deficiency against the corporation. When corporate items affect the shareholder, the Service still has three years to examine the propriety of the corporation's return and three years to examine the shareholder's treatment of the item on his or her individual return.

Both the corporation and the shareholder may agree to extend the limitations period.[10] If the corporation extends the period, the Service has more time to examine the corporation's income tax return. If the shareholder extends the period, the Service has more time to examine the shareholder's income tax return. If the corporation extends the period but the shareholder does not, no change made at the corporate level will affect the shareholder. If the shareholder extends the period but the corporation does not, no change

[9] As a practical matter, the shareholder is bound by the S corporation's income tax return. A shareholder has available and can report only the information supplied to him or her by the S corporation. That information is communicated by the S corporation in the form of a schedule K-1, a part of the Form 1120S, that the S corporation submits to the shareholder. *See, infra*, IV, pp. 45-6.

[10] Section 6501(c)(4) of the Code permits the Service and the taxpayer to consent in writing to an extension of the period of limitations with respect to income tax returns.

with respect to the treatment of items at the corporate level can be made at the shareholder level because the period for examination and assessment at the corporate level has passed.

While there is no disagreement that this is the result in the case of a C corporation, the Second Circuit treats an S corporation differently by arguing that the S corporation does not always file a "return." In its view, the S corporation files a "return" pursuant to section 6501(a) only in those years when it has a tax to pay. *Bufferd v. Commissioner*, 952 F.2d 675, 678 (2d Cir. 1992).

This Court has stated: "There is of course no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes," and the Court departs from the meaning of the words only when their plain meaning produces "absurd results" or a meaning "plainly at variance with the policy of the legislation as a whole." *United States v. American Trucking Assns., Inc.*, 310 U.S. 534, 543 (1940), citing *Ozawa v. United States*, 260 U.S. 178, 194 (1922).

The plain meaning of these sections produces logical, not absurd results. Moreover, the plain meaning furthers the legislative policies of certainty and finality. Properly read, sections 6501(a), 6012(a)(2), and 6037(a) provide that the "return" referred to in section 6501(a) is the S corporation's income tax return and not the shareholder's income tax return. The Ninth Circuit Court of Appeals viewed these three Code sections as an interdependent matrix, correctly deciding in *Kelley v. Commissioner*, 877 F.2d 756 (1989), that "the IRS may not adjust a shareholder's return based on an adjustment to an S corporation's return when the statute of limitations has run on the S corporation's return." 877 F.2d at 759.

In its opinion below, the Second Circuit stated: "At the heart of this dispute is the meaning of the word 'return' in section 6501(a)." *Bufferd v. Commissioner*, 952 F.2d at 677. Indeed, proper identification of the relevant "return" under section 6501(a) is the key to the resolution of this case. The Second Circuit, however, reads section 6501(a) in a vacuum, and ignores the clear and unambiguous language of both section 6012(a)(2) and the second sentence of section 6037(a)

that together define the term "return" in section 6501(a). Related statutory provisions must be read in their entirety. *Cippolone v. Liggett Group, Inc.*, ___ U.S. ___, 112 S. Ct. 2608, 2627 (1992), quoting *Jarecki v. G.D. Searle and Co.*, 367 U.S. 303 (1961); *see also, Hoffman v. Connecticut Dept. of Income Maintenance*, 492 U.S. 96, 103 (1989), quoting *United States v. Menasche*, 348 U.S. 528, 538-9 (1955).

The "return" referred to in section 6501(a), as required by sections 6037(a) and 6012(a)(2), is always that of the corporation. The Code makes no distinction in this regard between C and S corporations; nor does it make relevant whether a tax is assessed against the S corporation. Therefore, the Service may not make adjustments to items on a C or an S corporation's income tax return more than three years after that return was filed. Nor, consequently, may the Service assess any tax against a C or an S corporation's shareholder with respect to corporate items more than three years after the corporation's income tax return was filed unless the corporation has agreed to an extension of the period for assessment and the return of the shareholder's period of limitations is open.

In contrast to this logical synthesis of sections 6501(a), 6037(a), and 6012(a)(2), the court below proposed a strained explanation of section 6501(a) in relation to section 6012(a)(2) and the second sentence of section 6037(a). *Bufferd v. Commissioner*, 952 F.2d at 677. By reading the term "assessed" in section 6501(a) as inextricably linked to the term "return" in section 6501(a), the Second Circuit concluded that the "return" in section 6501(a) can only be a "return" of a taxpayer upon whom a tax could have been "assessed."

The court below interpreted the clear and unambiguous language of the second sentence of section 6037(a) as conditional. It read this sentence to provide that section 6012(a)(2)

refers to an S corporation's income tax return only in the following two circumstances:

> (1) When an S corporation income tax return is filed by an invalidly-elected S corporation,[11] or
>
> (2) When there is a tax imposed at the corporate level on the S corporation.[12]

The Second Circuit concluded that when an S corporation election is valid, and when there is no corporate level tax, the filing by an S corporation of its income tax return does not begin the running of the statute of limitations with respect to S corporation items. When, however, the election is invalid, or when there is a corporate level tax, the filing of the S corporation's income tax return does begin the running of the statute of limitations. As a result of this strained interpretation of the interaction of sections 6501(a), 6037(a), and 6012(a)(2), the Second Circuit concluded that the three-year limitation on the adjustments to a "return" in section 6501 refers sometimes to the S corporation's income tax return and sometimes to the shareholder's income tax return.

In the tax year at issue here, Compo had no income subject to tax. Therefore, the court below concluded that it was the filing of the income tax return of the Petitioner rather than the filing of Compo's income tax return that began the running of the period of limitations. Only by ignoring the interaction of sections 6501(a), 6037(a), and 6012(a)(2), *i.e.*, effectively omitting section 6012(a)(2) and the second sentence of section 6037(a) from application to an S corporation, can this interpretation be suggested. Thus, in *Bufferd,* (as in *Fehlhaber* and *Green*), the lower court's conclusion is without merit. There is no language in these three Code sections that supports the court's omission of two of these three co-equal provisions.

In *Fendell v. Commissioner,* 906 F.2d 362, 364 (8th Cir. 1990), the Eighth Circuit relied on the *Kelley* decision and held that the expiration of the limitations period for auditing

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[11] *Bufferd v. Commissioner,* 952 F.2d at 677.

[12] *Id.*

a trust's income tax returns barred adjustment of the amount of distributions claimed on its beneficiaries' individual income tax returns. The *Fendell* court reasoned that the Ninth Circuit *Kelley* case, and similar cases such as *Illinois Masonic Home v. Commissioner,* 93 T.C. 145 (1989), and *Boatmen's First Nat'l Bank v. United States,* 705 F.Supp. 1407 (W.D. Mo. 1988), "embody the principle that in order for the Commissioner to adjust tax liability, he must be able to do so at the source of income . . . or [he] will be prevented from doing so at the point where the income is distributed. . . . " *Fendell,* 906 F.2d at 364.[13]

The position of the Second Circuit appears to be that an S corporation is not the "source" of the income except in a year when the S corporation itself is subject to tax. This is yet another consequence of the court's view that the identity of the "return" in section 6501(a) varies with the annual corporate transactions, producing the uncertainty a limitations period should preclude. Application of the statute of limitations to the corporation must depend on the corporate act of filing a return and not upon whether the S corporation's election is valid or whether there is a tax imposed at the S corporation level.

II

AN S CORPORATION IS A CORPORATION (NOT A PARTNERSHIP) AND IT FILES A CORPORATE INCOME TAX RETURN.

A. AN S CORPORATION IS A CORPORATION AND SHOULD BE TREATED LIKE A C CORPORATION.

The background against which Congress enacted subchapter S[14] shows that in 1958 Congress had in mind a model for S corporations that departed markedly from the simple

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[13] The Service has announced its disagreement with the *Fendell* decision and its intent to continue to dispute the issue in other circuits. *Fendell,* AOD, CC-1991-01 (Feb. 11, 1991) and *Kelley,* AOD, CC-1991-08 (Mar. 29, 1991).

[14] Technical Amendments Act of 1958, Pub. L. No. 85-866, §64, 72 Stat. 1606.

"passthrough" regime that was generally applicable to partnerships.

Subchapter S represents Congress' attempt to remedy a dilemma that the tax laws previously had presented for many closely-held corporate businesses. The corporate form of doing business offers many protections to the entrepreneur under state law, most notably by affording the shareholder a large measure of insulation from personal liability for corporate obligations. The use of the corporate form, however, often entails a significant tax cost.

The most important such cost historically involved the Code's treatment of losses. It is not unusual for business ventures, especially in their startup years, to incur losses. If losses are incurred by a corporation, they can be deducted only by the corporation; the shareholder cannot deduct these losses against his or her own income. Because the startup corporation typically has no taxable income and therefore derives no value from a tax deduction, the corporation's loss is, in effect, nondeductible. Thus, use of the corporate form can deny the entrepreneur a deduction for losses that would be available if the entrepreneur conducted business directly.[15]

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[15] Another traditional tax cost of using the corporate form involves the "double taxation" of corporate earnings. The income of a corporation normally is taxed first under the corporate income tax. Then, the corporation's after-tax earnings will be taxed again to the shareholders if the earnings are distributed as dividends. For example, a corporation with income sufficiently high to place it in a top tax bracket might earn an additional $1,000 of taxable income from a particular activity. Under the rate structure applicable in 1979, this income might have been taxed at a corporate rate of 46 percent, leaving the corporation with $540 in after-tax income. *See* Code section 11 (1979). If distributed to the shareholders as a dividend, the $540 could be taxed again at an individual rate as high as 70 percent, leaving the shareholders with just $162. *See* Code section 1 (1979). Overall, the corporation's income would have been taxed at a total rate of well over eighty percent.

In practice, the double taxation of corporate earnings was not a major problem for closely-held corporations prior to 1986, because corporate tax rates historically have been lower than individual rates. Taxpayers often were content to earn income in the corporate form and to incur taxation at a relatively low rate, especially if there was no compelling reason to distribute the after-tax earnings as dividends. In 1986, however, Congress radically revised the rate structure, Pub. L. 99-514, §§101(a) and 601(a), 100 Stat. 2096 and 2249 (1986), and corporate rates today generally are higher than individual rates. *Compare* Code section 1 with Code section 11 as in effect in 1992. For this reason, the use of subchapter S, which avoids both these disadvantages, has gained significantly in popularity since 1986.

Partnerships have been traditionally distinguished from corporations for tax purposes. Unlike corporations, partnerships are not themselves subject to tax. Instead, the income, losses, and tax credits of a partnership generally are deemed earned and incurred directly by the partners according to their interests in the partnership. Thus, a partner can, as a general matter, claim his or her share of tax credits and deduct his or her share of partnership losses against income from other sources. The tax advantages of a partnership, however, were available only at a very substantial nontax cost, because the partnership, at least in its traditional form, offers no state law protection against individual liability.

Serious proposals to modify the tax treatment of closely-held corporations were made at least as early as 1946. *See generally,* James S. Eustice and Joel D. Kuntz, *Federal Income Taxation of S Corporations* (hereinafter "Eustice & Kuntz") Par. 1.02 (1985). A Treasury study of that year proposed treating closely-held corporations as partnerships. Richard B. Goode, *The Postwar Corporation Tax Structure* (Treasury Dept. 1946), *reprinted in part* in Eustice & Kuntz at Appendix B.1. In 1954, the Eisenhower Administration made a similar proposal, under which closely-held corporations could elect partnership treatment. *See,* Eustice & Kuntz at Par. 1.02[2]. The Senate adopted this proposal as part of its version of Congress' massive rewriting of the tax laws in 1954, although the proposal was eliminated in conference and did not become law. H.R. 8300, §1351, 83d Cong., 2d Sess. (1954), 100 Cong. Rec. 9034 (1954), *reprinted in* Eustice & Kuntz at Appendix B.2.[16]

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[16] In 1954, Congress amended the tax law to allow partnerships to elect to be taxed as corporations, Revenue Act of 1954, Pub. L. 83-591, 68A Stat. 1, but repealed this change in 1958. Technical Amendments Act of 1958, Pub. L. 85-866, §63, 72 Stat. 1605. Thus, today, as prior to 1955 and after 1958, partnerships are never taxable entities.

In 1958, Congress inserted into the Code the first version of subchapter S. In enacting subchapter S in 1958, Congress did *not* adopt the prior proposals to tax certain closely-held corporations as if they were partnerships. Instead, as enacted in 1958, subchapter S permitted a corporation, which had no more than ten shareholders and met other requirements,[17] to elect to be taxed under what have been described as "m: "fied corporate rules."[18]

Under the 1958 version of subchapter S, a qualified S corporation[19] was not itself subject to the corporate income tax. Code section 1374. In this respect, the treatment of S corporations was similar to that of partnerships.

In their treatment of the corporation's income, however, the 1958 subchapter S rules differed significantly from the rules applicable to partnerships. Section 1373(b) provided:

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[17] In general, a corporation could enjoy the benefits of subchapter S, under the 1958 version of the statute, if it made an election to be so covered and if it did not –

(1) have more than 10 shareholders;
(2) have as a shareholder a person (other than an estate) who was not an individual;
(3) have a nonresident alien as a shareholder; and
(4) have more than one class of stock.

Code section 1371 (1958). The corporation's subchapter S election could be terminated if the corporation earned more than 80 percent of its gross receipts from outside the United States, or derived more than 20 percent of its gross receipts from such "passive" sources as royalties, rents, dividends, and interest. Code section 1372(e)(4)-(5) (1958). These rules had evolved to some extent by 1979; *e.g.*, the Code in 1979 allowed the subchapter S corporation to have as many as 15 shareholders. Code section 1371 (1979).

[18] *See*, H.R. Rep. No. 826, 97th Cong., 2d Sess. 6 (1982) and S. Rep. No. 640, 97th Cong., 2d Sess. 6 (1982).

[19] A note about terminology is in order. From 1958 until 1982, the Code denominated corporations that were eligible for treatment under subchapter S as "electing small business corporations." Code §1371(b). Such corporations were commonly called "subchapter S corporations." *Cf., e.g.*, Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders*, Par. 6.02 (3d ed. 1971). In 1982, in connection with a substantial rewriting of subchapter S described below, Congress established the contemporary term "S corporation." Pub. L. No. 97-354, §2, 97th Cong., 2d Sess. (1982), *adding* Code §1361.

> (b) Amount included in gross income. – Each person who is a shareholder of an electing small business corporation on the last day of a taxable year of such corporation shall include in his gross income, for his taxable year in which or with which the taxable year of the corporation ends, the amount he would have received as a dividend, if on such last day there had been distributed pro rata to its shareholders by such corporation an amount equal to the corporation's undistributed taxable income for the corporation's taxable year. For purposes of this chapter, the amount so included shall be treated as an amount distributed as a dividend on the last day of the taxable year of the corporation.

The instruction that a pro rata portion of the corporation's income shall be included in the shareholder's gross income only to the extent of the "the amount he would have received as a dividend" represents a wholesale incorporation of a central concept of corporate tax law. Distributions from a corporation are treated as dividends under the corporate tax rules only to the extent they are made "out of [the corporation's] earnings and profits." Code section 316(a) (1979). "Earnings and profits" is, in turn, a measure of a corporation's economic income that has no real analogue outside the corporate tax rules.[20] Congress, in 1958, thus limited an S corporation shareholder's liability for taxation on the corporation's income by the corporation's "earnings and profits," a peculiarly "corporate" measure of income.

Another peculiar consequence of the incorporation into subchapter S of the dividend rules of the corporate tax was

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[20] "Earnings and profits" is among the more confusing concepts in federal taxation. A corporation's earnings and profits generally will differ from its taxable income. Interest on tax exempt bonds, for example, is not included in determining a corporation's taxable income, but is included in determining a corporation's earnings and profits. The prominent role given by the corporate tax rules to earnings and profits has been subject to a great deal of criticism over the years, but it remains central to corporate taxation. *See, e.g.*, Walter E. Blum, *Repeal of the "Earnings and Profits" Concept*, 22 San Diego L. Rev. 205 (1985).

the general failure of subchapter S to provide for the passthrough of the "character" of the corporation's income. If, for example, a partnership earns interest on tax exempt state or local bonds, the tax exempt character of the interest traditionally has "passed through" to the partners. With the special exception of a rule providing for the passthrough of capital gains characterization,[21] however, income deemed earned by an S corporation's shareholder under the 1958 rules was simply "dividend" income; it did not retain its character as earned by the corporation.[22] This "bottom line" passthrough is directly analogous to the characterizaton of distributions from a C corporation as dividends to the shareholder and quite diferent from the carryover of the character of individual items from a partnership to a partner.

With certain inapplicable exceptions,[23] a C corporation income tax return is subject to a three-year period of limitations under sections 6012(a)(2) and 6501(a) of the Code. The Service may not adjust a C corporation shareholder's income tax return as a result of adjustments to the C corporation's return after the expiration of the corporation's three-year period of limitations. But in the view of the Second Circuit, the rule should be different for an S corporation because an S corporation is not a separate taxable entity. In the lower court's view, adjustments to an S corporation's income tax return always affect a shareholder's income tax return, while adjustments to a C corporation's income tax return never

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[21] Code section 1375(a)(1) (1958).

[22] *Cf.* Code section 1373 (1958) ("For purposes of this chapter, the amount . . . included [in the income of the subchapter S shareholder] shall be treated as an amount distributed as a dividend. . . . "). The 1958 legislative history indicates that this "corporate" result was not accidental:

> Generally, [the corporation's] income is treated as ordinary income to the shareholder without the retention of any special characteristics it might have had in the hands of the corporation. This rule has been adopted so that this provision can operate in as simple a manner as possible. Long-term capital gains, however, are an exception to this general rule. S. Rep. No. 1983, 85th Cong., 2d Sess., 1958-3 C.B. at 1009.

[23] *See*, for example, the exceptions to section 6501(a) provided in section 6501(c).

affect a shareholder's income tax return, because a C corporation is a separate taxable entity.

That view is wrong. Adjustments to an S corporation's income tax return may not affect a shareholder's income tax return. For example, adjustments that affect the income tax liability of the S corporation itself will not affect the shareholder's income tax return. Moreover, adjustments to a C corporation's income tax return can affect the income tax return of a shareholder. For example, under sections 301(c), 312(a), and 316(a), a shareholder treats a distribution from a C corporation, depending on the amount of the corporation's earnings and profits, as either a dividend, a return of capital, or a gain from the sale or exchange of property. Because adjustments to a C corporation's income tax return could affect the amount of earnings and profits of the corporation, these adjustments can have an impact on the treatment of a distribution that the corporation's shareholder receives and may have to report on his or her individual income tax return.

The following example illustrates the interaction of the tax rules and the statute of limitations rules for a C corporation:

> X formed C Corporation on July 1, 1978 by transferring $50,000 cash to C Corporation. C Corporation manufactured and sold widgets. For its taxable year, July 1, 1978 to June 30, 1979, C Corporation timely filed a Form 1120 corporate income tax return showing gross income of $120,000 and deductions of $121,000 for a net loss of $1,000.
>
> On April 1, 1979, C Corporation made a $3,000 cash distribution to X. X timely filed his 1979 individual income tax return and did not include the $3,000 in his income, treating it as a return of capital under section 301(c)(2)(A) of the Code.
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> C Corporation's statute of limitations expired while the Service was timely auditing X's 1979 income tax return. During the audit, while considering the $3,000 distribution, the Service determined that C Corporation had unintentionally, but improperly, deducted $5,000 so that it should have reported $4,000 in income rather than a $1,000 loss.

> As a result, X should have treated the $3,000 distribution as a dividend to X under section 301(c)(1) of the Code. Because the Service did not obtain an extension of C Corporation's period of limitations, the Service cannot include the $3,000 in X's income on his 1979 individual income tax return.

The foregoing example demonstrates that adjustments made at the C corporation level may have an immediate impact on the shareholder's income tax return despite the fact that a C corporation and its shareholder are separate taxable entities.

In *Moline Properties Inc. v. Commissioner*, 319 U.S. 436 (1943), this Court enunciated the fundamental principle governing corporate taxation:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors . . . so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. 319 U.S. at 438.

This Court has recently reaffirmed the *Moline Properties'* doctrine in *Commissioner v. Bollinger*, 485 U.S. 340 (1988), stating that "a corporation is a separate taxable entity even if it has only one shareholder who exercises total control over its affairs." 485 U.S. at 345. That the separate entity doctrine has also been accepted by Respondent in the context of an S corporation is demonstrated by its failure to "nonacquiesce" to the Tax Court's decision in *Crook v. Commissioner*, 80 T.C. 27, 33 (1983), *aff'd without opinion*, 747 F.2d 1463 (5th Cir. 1984).[24]

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[24] The Commissioner of Internal Revenue issues either an "acquiescence" or "non-acquiescence" with respect to many Tax Court decisions in order to inform the field staff of the Service throughout the country, as well as the general public, how the Service intends to handle cases with similar fact patterns in the future. The acquiescence or non-acquiescence generally remains in effect until a number of lower courts issue opinions contrary to the Service's position, this Court issues an opinion with respect to the fact pattern, or Congress acts to resolve the issue legislatively.

Yet, the court below appears to believe that the S corporation and its shareholders are not separate taxable entities filing separate income tax returns. The court's contention that the shareholder's return is the relevant return for statute of limitations purposes disregards the S corporation as a separate entity and the S corporation's income tax return as a separate income tax return. This view is inconsistent with the concern expressed by this Court in *Bollinger* that the separate entity doctrine of *Moline* not be subverted. 485 U.S. at 340.

It is always the C corporation's income tax return that begins the running of the statute of limitations. By contending that a different statute of limitations rule applies to an S corporation because an S corporation, unlike a C corporation, is not a taxable entity or is generally not a taxable entity, the Second Circuit ignored the fact that a C corporation, during one or more of its taxable years, may not be liable for any tax because it has suffered a loss rather than having taxable income. The Service certainly would not assert that in such cases the three-year period of limitations under section 6501(a) is inapplicable to the C corporation's income tax return.

It is altogether reasonable for Congress to have limited the vulnerability to audit of the shareholder of the S corporation to the three-year period during which the corporation is required to retain its records for the taxable year. The court below dismissed this concern cavalierly: "We believe that a shareholder of an S corporation can take . . . protective steps with regard to the S corporation records needed to support the S corporation items claimed on the shareholder's return." J.A. 72. It is difficult to say what basis, however, the court below had for this conclusion. As of 1979, S corporations could have up to fifteen shareholders. It is very easy to conceive of circumstances in which a one-fifteenth shareholder would

have absolutely no control over the actions of a corporation's management.[25]

In addition, Congress could well have perceived a need for a single limitations period applicable to all corporations. Under the rules that Congress established in 1958, corporations could lose their qualification for treatment under subchapter S by violating any of a number of sometimes detailed rules, notably those denying qualification if more than twenty percent of the corporation's income was derived from "passive" sources. (Partnerships, in contrast, generally were not subject to such rules.[26]) As a practical matter, Congress likely envisioned that the Service would seek to examine the corporation's eligibility for subchapter S status, and the validity of the corporation's report of its various items of income, deduction, and credit in the same tax audit. It was thus natural in 1958 for Congress to have based the applicable limitations period on the filing of the S corporation's return as is the case for a C corporation.

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[25] This court also should not view a shareholder's "voluntary" consent to extend the limitations period for the shareholder's individual return as in any way reflecting a considered decision, by the shareholder, that S corporation records remain available. During the course of an audit, the Service almost invariably asks the taxpayer to consent to an extension of the limitations period. If the taxpayer refuses, Respondent's normal practice is to assess a very high deficiency, based on the Service's estimate as to the taxpayer's maximum possible exposure. Thus, in practice, the taxpayer typically has no real choice but to "consent" to the extension.

[26] The question will occasionally arise whether an entity designated as a partnership should nevertheless be taxed as a corporation. Because of the tax benefits sometimes associated with partnership status, the tax law does not consider an entity's formal characterization as a partnership, under state law, to be determinative for tax purposes. Instead, under a "corporate resemblance" test, the Service can recharacterize a partnership as a corporation in some circumstances if the legal arrangements among the partners (*e.g.*, with respect to centralized management and free transferability of interests) are typical of those normally made among shareholders. *See* 26 C.F.R. §301.7701-1 *et seq.* The Code does not, however, contain precise requirements for partnership status analogous to those applicable to subchapter S corporations. It is unusual for a partnership to be recharacterized as a corporation under the regulatory "corporate resemblance" test, and in practice the test is sparingly applied.

Furthermore, because the primary motivation for entrepreneurs to use an S corporation was to make possible the deduction of corporate losses, Congress very likely expected that many shareholders would revoke their subchapter S elections after the initial years of a venture, when startup losses turned to profits. Indeed, such a practice became quite common following the enactment of subchapter S in 1958. Congress therefore likely contemplated that, for much of their corporate existence, corporations established originally as subchapter S corporations would, in fact, be subject to the regular rules of corporate taxation. It was consequently quite natural for Congress to treat a subchapter S income tax return consistently with a subchapter C income tax return.

B. AN S CORPORATION IS A CORPORATION AND SHOULD NOT BE TREATED LIKE A PARTNERSHIP.

Subchapter S of the Code was enacted in 1958 to provide rules for small business corporations to elect to be taxed differently from C corporations.[27] It is often said that S corporations are taxed, like partnerships, as passthrough entities.[28] This characterization is not accurate. Congress did not choose to apply subchapter K partnership rules to S corporations.[29] Rather, it added subchapter S to the Code, which,

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[27] Technical Amendments Act of 1958, Pub. L. No. 85-866, §64, 72 Stat. 1606.

[28] *Fehlhaber v. Commissioner*, 954 F.2d at 655; and *Green v. Commissioner*, 963 F.2d at 786.

[29] In The Revenue Act of 1954, Pub. L. No. 83-591, 68A Stat. 1, section 1361 was enacted to permit sole proprietorships and partnerships to elect to be taxed as C corporations. The Senate also attempted to add section 1351 to the Code which would have allowed corporations to elect to be treated as partnerships. S. Rep. No. 1622, 83rd Cong., 2d Sess. 1, 118. The Senate simply provided that all the partnership rules of subchapter K applied to these electing corporations including formation, operation, distributions, liquidation, sales of interests, and any other purposes. This Senate bill was deleted by Amendment No. 259 of the Conference Committee. H.R. Rep. No. 2543, 83rd Cong., 2d Sess. 1, 72.

while bearing some similarity to subchapter K, also created unique provisions to retain the separate entity doctrine that applies to S corporations.

Respondent suggests that there is no reason for Congress to have departed from the partnership approach. In fact, there are ample reasons why Congress in 1958 would have desired to establish, in its rules governing subchapter S returns, a regime different from that applying to partnerships. Most important is the dependence of the shareholder's liability on the amount of the corporation's "earnings and profits." Congress would logically have desired to permit adjustments to the shareholder's returns only during such period as the corporation remained on notice of the need to retain detailed financial records. Statutes of limitations, under the tax laws, serve the important purpose of signalling to the taxpayer the period during which it is necessary to keep detailed records.[30] As this Court noted in *Rothensies v. Electric Storage Battery Co.*: "a statute of limitations is an almost indispensible element of fairness as well as of practical administration of an income tax." 329 U.S. 296, 301 (1946).

In this respect Congress could well have been influenced by the different levels of control over the entity held by partners and shareholders, especially minority shareholders, under the traditional common law. A partner, traditionally,

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In 1958, when subchapter S of the Code was added, Congress rejected its previous approach to applying subchapter K provisions to electing small business corporations. Rather, it adopted subchapter S which contains many provisions different from subchapter K. The application of subchapter K provisions to electing small business corporations was considered and rejected, and as such its absence from the taxing regime of these corporations reflects Congress' intent that application of the partnership provisions is inappropriate.

[30] The statute of limitations exists, in part, so that after some time persons can be confident that their affairs are closed and they can dispose of old records. An S corporation should be entitled to the same finality as other entities, yet if any shareholder has given an extension of the statute of limitations to the Service, the shareholder's ability to defend against the adjustment would (under the government's view of the issue in this case) depend upon whether the corporation has retained the records. *Kelley, supra*, 877 F.2d at 758.

participates actively in partnership management and exercises direct control over the entity's affairs.[31] In contrast, a shareholder of a corporation, even one with only ten shareholders, may have little if any influence on the corporation's day-to-day affairs, and may have little control over the retention of corporate records.

The differences between subchapter S (small business corporations) and subchapter K (partnerships) have become more marked during the years since 1958. Taxes have been imposed on S corporations since 1966 but not on partnerships. Subchapter S rules were simplified in 1982, but nothing has changed the original intent of Congress to maintain a separate set of rules for S corporations and partnerships.

In *Flynn v. Commissioner*, 93 T.C. 355 (1989), the Tax Court cited the following language of Senate Report No., 97th Cong., 2d Sess:

> Because of the passthrough of income and loss to the shareholders of a subchapter S corporation, subchapter S is often described as a method of taxing corporations as if they were partnerships. In fact, *there are a number of significant differences* in tax treatment under the partnership provisions (subchapter K) and the subchapter S provisions. 93 T.C. at 362 (emphasis added).

Just as Congress did not adopt the partnership model in the substantive treatment of S corporations, Congress departed from the partnership model in the limitations area. As of 1979, section 6031 contained the following requirement with respect to partnerships:

> Every partnership . . . shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, and such other information for the purpose of carrying out the provisions of subtitle A as

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[31] This is not, of course, true of the contemporary limited partnership. It would seem likely, however, that in 1958, most legislators' perceptions of a partnership would have been influenced more strongly by models of the traditional general partnership than of the limited partnership.

> the Secretary may by forms and regulations prescribe, and shall include in the return the name and addresses of the individuals who would be entitled to share in the taxable income if distributed and the amount of the distributive share of each individual.[32]

The corresponding provision for subchapter S corporations contains language similar, *but not identical*, to that of the provision applying to partnerships. Section 6037 of the Code provides:

> Every electing small business corporation (as defined in section 1371(b)) shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, the names and addresses of all persons owning stock in the corporation at any time during the taxable year, the number of shares of stock owned by each shareholder at all times during the taxable year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, and such other information, for the purpose of carrying out the provisions of subchapter S of chapter 1, as the Secretary may by forms and regulations prescribe. *Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.* (emphasis added).

This highlighted language contrasts Section 6037 with the corresponding provision governing partnerships; in the words of the court below, Section 6031(a), governing partnership returns, "has no similar provision relating to the effect of those returns on the limitations period." J.A. 70. Section 6037 clearly reflects a deliberate decision to apply different rules of limitation to partnerships and S corporations.

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[32] The language of this statute has not changed between 1958 and the present, except that the words "or his delegate" following "Secretary" were removed in 1976. Pub. L. No. 94-455, Sec. 1906(b), 90 Stat. 1834.

Prior to its decision in *Bufferd*, 952 F.2d 675 (2d Cir. 1992), the Second Circuit, too, recognized the distinction between an S corporation and a partnership. When it held in *Siben v. Commissioner*, 930 F.2d 1034 (2d Cir. 1991), that the Service may make adjustments on a partner's return with respect to partnership items, notwithstanding the expiration of the three-year statute of limitations period for the partnership return, it distinguished *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989), which dealt with an S corporation.

In distinguishing an S corporation from a partnership in *Siben*, the Second Circuit noted its earlier decision in *Ketchum v. Commissioner*, 697 F.2d 466 (2d Cir. 1982). The court stated in *Ketchum* that "as long as the sections of the Code governing subchapter S corporations differ from the partnership provisions, *we are obliged to apply those sections differently*, and taxpayers will gain or lose from those differences as the case may be." 697 F.2d at 471 (emphasis added). The court noted in *Siben* that "§6037, relating to S corporations, has no counterpart in the partnership provisions." 930 F.2d at 1037. Thus, as explained in *Ketchum* and reiterated in *Siben*, Congress chose to treat S corporations differently from partnerships and created a separate statutory scheme to reach its objective.

In its decision below, the Second Circuit ignored its own admonition to treat an S corporation differently from a partnership. Rather, the court concluded that the income tax return of the S corporation's shareholder, like a partner's income tax return, determines the period of limitations under section 6501(a). Yet, as the Second Circuit itself recognized, there is no provision in the Code for partnership returns analogous to the second sentence of section 6037(a).[33] Nor does section 6012 designate a partnership as a person required to file a return. Despite the Second Circuit's recognition of the difference in the statutory schemes governing S corporations and partnerships (*Siben*, 930 F. 2d at 1037; *Ketchum*,

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[33] Section 6031 of the Code does provide a rule for partnerships analogous to the first sentence of section 6037(a).

697 F.2d at 471), it failed to grasp the significance of these differences and consequently did not reach a different result in *Bufferd* from the result in *Siben*. *Bufferd*, 952 F.2d at 677.

C. AN S CORPORATION RETURN IS A TAX RETURN, NOT AN INFORMATION RETURN.

An S corporation return is a tax return like that of a C corporation and not an information return like that of a partnership. Therefore, it is to the S corporation's return that section 6501(a) refers, in every year in which the S corporation is required to file a return. Section 6012(a)(2) requires an S corporation to file a return every year, not merely in years in which it is subject to tax. Congress did not limit the applicability of section 6012(a)(2) to C corporations and invalidly-elected S corporations.

The second sentence of section 6037(a), which plainly includes "any" S corporation return, refers to section 6012, as the paragraph requiring a corporation to file an income tax return and to Chapter 66, the chapter containing the limitations provisions. Paragraph (2) of section 6012(a) is the only paragraph in section 6012 applicable to a corporation and section 6501(a) is the section in Chapter 66 that contains the limitations rule for returns filed pursuant to section 6012. Although section 6012(a)(2) refers to a corporation subject to taxation, and no income taxes were imposed on S corporations at the time that Congress drafted the second sentence of section 6037(a) in 1958, section 6037(a) clearly states that the S corporation return shall be treated as the return required by section 6012 that begins the limitations period. Furthermore, S corporations have been "subject to taxation" since the 1966 amendments.[34]

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[34] Beginning in 1966, section 1378 imposed an S corporation-level income tax on certain S corporation capital gains. Small Business Corporations Act, Pub. L. 89-389, §2(a), 80 Stat. 111. Because these capital gains were so-called "preference" items under section 57 of the Code, an S corporation taxable under section 1378 might be subject to the "minimum tax" under sections 56 and 58(d)(2) of the Code then in effect. Section 1378 was re-enacted as section 1374 in 1982. Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669. It was then modified in both 1984 and 1986, imposing different S corporation-level income taxes on S corporations. Deficit Reduction Act of 1984, Pub. L. No. 98-369, §721(v), 98 Stat. 971 and Tax Reform Act of 1986, Pub. L. No. 99-514, §632(a), 100 Stat. 2275. Modifications to section 1378 as originally enacted all occurred after the taxable year at issue in this case. Nevertheless, it is clear that from 1966 through the present, an S corporation is a "corporation subject to taxation" described in section 6012(a)(2).

The notion that an S corporation's return is a "return" only when the corporation actually has tax liability is also contrary to Respondent's own regulation. In September 1958 the Treasury proposed, and in February 1959 adopted, Regulation section 1.6012-2(a)(1), which provides that "every corporation as defined in section 7701(a)(3), subject to taxation under subtitle A shall make a return of income *regardless of whether it has taxable income*. . . . " (emphasis added). This regulation, issued almost contemporaneously with the enactment of section 6037(a) in 1958, strongly militates against giving a subchapter S corporation's return significance only when it has a tax liability.

When Respondent argued in the Second Circuit that there is no tax to be assessed under section 6501(a) with respect to an S corporation, and thus there is no applicable limitations period with respect to an S corporation return, it relied upon *Leonhart v. Commissioner*, 27 T.C.M. (CCH) 443, *aff'd per curiam*, 414 F.2d 749 (4th Cir. 1969). Respondent's reliance on *Leonhart* is misplaced. First, the Tax Court in *Leonhart* implicitly, with no analysis, made the same mistake as the Second Circuit made here in connecting the word "return" with the word "assessment" in section 6501(a). Even before enactment of section 1378 imposing a corporate level tax, there was always an occasion for a period of limitations with respect to an S corporation given a proper interpretation of the word "return" in section 6501(a). There is no inextricable linkage between the taxpayer making the return and the taxpayer against whom there can be an assessment.

Second, even if the Tax Court was correct in *Leonhart*, its conclusion is no longer valid. Vital to the *Leonhart* holding and, therefore, to Respondent's argument, is the notion that a validly-elected S corporation will never be subject to taxation. (*Leonhart* concerned a year prior to enactment of section 1378 when no tax could be assessed on an S corporation.) Indeed, in *Leonhart* the Tax Court stated:

> [W]here an eligible small business corporation makes a valid election under Subchapter S the statute contemplates that no income taxes are to be paid by it and therefore that there would be no occasion for a period of limitation on assessment and collection with respect to the corporation. 27 T.C.M. (CCH) at 462.

While there was no tax imposed at the S corporation level for the taxable year at issue in *Leonhart*, this is no longer true. Under section 1378, enacted in 1966 after the tax year in question in *Leonhart*, a tax can be imposed on the income of an S corporation if the S corporation has a recognized capital gain for the taxable year or is subject to the minimum tax. Thus, after 1966 and continuing to the present, an S corporation is a "corporation subject to taxation" under section 6012(a)(2).

Paramont Land Company, Inc. v. United States, 727 F.2d 322 (4th Cir. 1984), illustrates the manner in which an S corporation may be taxed at the corporate level on capital gains income notwithstanding a valid S corporation election. The Court of Appeals for the Fourth Circuit, finding that Paramont Land met the requirements detailed in section 1378, held that income received by the S corporation from leasing coal properties was a capital gain within the meaning of section 1378's statutory exception to the general scheme of treatment for subchapter S taxpayers. The court thus affirmed the assessment of tax under section 1378 at the S corporation level. 727 F.2d at 324.

The enactment of section 1378, as demonstrated in the *Paramont Land* case, renders *Leonhart* inapplicable to post-1966 cases. To argue that an S corporation is not a

taxable entity, and, thus, not subject to a limitations period, is contrary to the explicit, unambiguous provisions of the Code.

The enactment of section 1378 transformed an S corporation into a taxable entity. Since its enactment, an S corporation, unlike a partnership, is subject to taxation in some years, although it may not be taxed in all years. The Second Circuit pointed out in *Klein v. Commissioner*, 537 F.2d 701, 704 (2d Cir. 1976), *cert. denied*, 429 U.S. 980 (1976), that a partnership can never be a taxable entity and can never be subject to any tax imposed by the Code.[35]

The three circuit courts in *Bufferd*, *Fehlhaber*, and *Green* attempt to create a new exception to corporations described in section 6012(a)(2): corporations not "generally" subject to income taxation. For example, in *Fehlhaber* the Eleventh Circuit stated:

> Most importantly, section 6012 provides, in relevant part, that '[e]very corporation subject to taxation *under subtitle A*' is required to file an income tax return. This reference strains Fehlhaber's interpretation because, as we noted above, an S corporation is a *'flow-through' entity* and is not *generally* separately taxable. *Fehlhaber*, 954 F.2d at 656 (emphasis added).

The attempt to categorize corporations not generally subject to income taxation as exempt from the filing requirements of section 6012(a)(2) is incorrect. Section 6012(a)(2) provides that even in years when no tax liability is imposed at the S corporate level, an S corporation is "subject to" taxation, and pursuant to both sections 6012(a)(2) and 6037(a) it must file a return. Indeed, as noted, the applicable Regulation provides "[e]very corporation, as defined in section 7701(a)(3), subject to taxation under subtitle A of the Code shall make a return of income regardless of whether it has taxable income or regardless of the amount of its gross income." Regulation section 1.6012-2(a)(2). There is simply no language in the Code (or Regulations) that creates an

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[35] The Second Circuit in *Klein* referred only to income taxes. Partnerships are, of course, subject to a number of other taxes, *e.g.*, employment taxes.

exception to the explicit directive of sections 6012(a)(2) and 6037(a) that all corporations, including all S corporations, must file yearly income (not information) tax returns.

Respondent's argument that an S corporation's income tax return, Form 1120S, is an information return, as is the case with a partnership or an exempt organization's return (*see, Automobile Club of Michigan v. Commissioner,* 353 U.S. 180 (1967)), is wholly without merit.[36] The Service promulgated Form 1120S for 1978 (the S corporation's taxable year at issue). The Service did not designate the Form 1120S as an information return. Rather, the Service titled the Form 1120S as "U.S. Small Business Corporation Income Tax Return." The S corporation, Compo, filed a return on Form 1120S for the taxable year ending November 30, 1979 (J.A. 38-42).

Compo's Form 1120S was not merely an information return. On lines 29-31 on the 1978 Form 1120S, the Service provided for the reporting, at the corporate level, of the S corporation's tax liability: income tax on capital gains (line 29), minimum tax (line 30), and total tax (line 31). In addition, the Service promulgated a separate Schedule D to accompany Form 1120S allowing the S corporation to compute its capital gains and capital losses. Lines 29-31 on Form 1120S provide clear evidence that the Service recognizes an S corporation as a separate taxable entity. This form has provided for the computation of an S corporation level tax since the enactment of section 1378 in 1966. This form refutes Respondent's argument that an S corporation is a pure passthrough entity like a partnership and that its return is merely an information return.

The Service also promulgated Form 1065, "U.S. Partnership Return of Income." There is no provision on Form 1065

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[36] The Petitioner believes that *Automobile Club of Michigan v. Commissioner,* 353 U.S. 180 (1967), is not relevant to this case. In that case the organization was declared to have violated tax exempt organization status and therefore was taxed as a C corporation. This is analogous to a situation in which an S corporation made an invalid election.

for the computation of any tax because, unlike an S corporation, a partnership is never a taxable entity. Nor is the partnership return titled an "Income Tax Return." Thus, on its own forms the Service treated an S corporation as a separate taxable entity while treating a partnership as a pure passthrough entity.

By erroneously equating an S corporation income tax return, Form 1120S, and a partnership information return, Form 1065, the Eleventh Circuit mistakenly concluded that the S corporation's income tax return is merely the information return of a passthrough entity.[37] But an S corporation return is not merely an information return and an S corporation is not merely a passthrough entity. As a result of section 1378, it is a "corporation subject to taxation" under section 6012(a)(2). Thus, the return of an S corporation is an income tax return.

The Second Circuit ignored the statutorily prescribed function of the S corporation return, Form 1120S, as an income tax return. Its view of the function of the return ascribes a dual nature to an S corporation's income tax return. If an S corporation owes any tax for a taxable year, its return for that taxable year constitutes an income tax return. If, however, that same S corporation does not owe any tax for a taxable year, its return constitutes an information return. This judicial alchemy produces the absurd result that a tax liability of one dollar owed by the S corporation, whether or not originally reported on the return, changes the status of the return from an information return to an income tax return. It also changes the return that begins the running of the statute of limitations under section 6501(a) from the income tax return of the S corporation's shareholder to the S corporation's income tax return.

Acceptance of this construction would unjustly magnify the importance of the financial activities of an S corporation in any taxable year. Applying the more natural construction to the language of these three Code sections requires that the

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[37] *Fehlhaber v. Commissioner,* 954 F.2d at 657.

nature of the entity, rather than the nature of the transactions of a given taxable year, determines the identity of the "return" that begins the running of the statute of limitations.

III

RESPONDENT'S ARGUMENTS FOR IGNORING THE STATUTE'S PLAIN MEANING ARE WITHOUT MERIT.

A court need only resort to the legislative history when there are "patent ambiguities" in the statutory language. *American Community Builders v. Commissioner,* 301 F.2d 7, 13 (7th Cir. 1962); *accord, United States v. Blasius,* 397 F.2d 203, 206 (2d Cir. 1968). Even if the statutory scheme were not clear and unambiguous on its face, however, the legislative history substantiates the position of the Petitioner and the Ninth Circuit.

Congress enacted subchapter S and section 6037 in 1958.[38] In relevant portion, the 1958 Report of the Senate Finance Committee on the Technical Amendments Act[39] that added subchapter S and section 6037 to the Code, provides:

> Notwithstanding the fact that an electing small-business corporation *is not subject to the tax* imposed by chapter 1 of the 1954 Code, such corporation *must make a return* for each taxable year in accordance with new section 6037 as added by subsection (c) of section 68 of the bill. *Such return* will be considered as *a return filed under section 6012* for purposes of the provisions of chapter 66, relating to limitations. Thus, *for example, the period of limitation on assessment and collection of any corporate tax found to be due upon a subsequent determination that the corporation was not entitled to the benefits of subchapter S, will run from the date of filing of the return required under the new section 6037.* S. Rep. No. 1983 at 5014 (emphasis added).

[38] Technical Amendment Act of 1958, Pub. L. No. 85-866, §64(c), 72 Stat. 1606.

[39] S. Rep. No. 1983, 85th Cong., 2d Sess. 1019, *reprinted in* 1958 U.S. Code Cong. & Admin. News 5005 (hereinafter "Senate Report").

On the basis of this language, Respondent suggests that the second sentence of section 6037(a), describing an S corporation's return as one that satisfies section 6012 and begins the period of limitations, applies only when the S corporation is subject to tax or its election is invalid. This is untrue. The second sentence of section 6037(a) clearly provides on its face that "*any return* filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as filed by the corporation under section 6012" (emphasis added). An interpretation of the legislative history of section 6037(a) that limits the application of the sentence only to entities that are ineligible for treatment as S corporations ignores the "any return" language contained in the statute itself.

When Congress enacted section 6037(a) in 1958, a determination that the corporation was not entitled to the benefits of subchapter S was the *only* occasion on which an S corporation could itself be subject to tax.[40] The first sentence of the Senate Report clearly demonstrates that, at the time section 6037(a) became effective, Congress knew that an electing small business corporation was not subject to the tax imposed by Chapter 1. Section 6037(a) was not needed if it was to

[40] In order for a corporation, normally subject to taxation as a C corporation, to be treated as an S corporation, it must satisfy two requirements. First, it must make a proper election that fulfills all requirements prescribed by section 1372. Second, it must also qualify as a "small business corporation" pursuant to the definition in section 1371. Thus, a corporation will not be eligible to be taxed under subchapter S if it fails to satisfy either the procedural election requirement under section 1372 or the substantive definitional requirement under section 1371. Beginning in 1966, Congress provided for various other circumstances in which the subchapter S corporation could itself become subject to taxation. *See, e.g.*, Pub. L. 89-389, §2(a), 80 Stat. 111 (1966) (adding initial version of 26 U.S.C. §1378, subsequently amended many times, subjecting subchapter S corporation to taxation on certain extraordinary capital gains). Under the 1958 version of the statute, however, in which Congress enacted section 6037(a), a subchapter S corporation could become subject to taxation *only* if its election was terminated.

apply only to ineligible S corporations. An ineligible S corporation would automatically be subject to the existing rules for C corporations.

Congress also knew when it added section 6037(a) that the paragraph in section 6012(a) only that referred to a corporation was paragraph (2). Yet, Congress drafted the second sentence of section 6037(a) to provide that *any return* of an S corporation shall be treated as a return filed by the *corporation* under section 6012. Thus, Congress could not have intended that the S corporation return filed under section 6012 be only a return under section 6501(a) when the S corporation election was invalid or the S corporation was subject to taxation.

The words "for example" in the legislative history of section 6037(a) indicate that Congress did *not* intend its reference to the statute of limitations in section 6037(a) to apply *only* when the subchapter S corporation, itself, was subject to taxation.[41] This Court stated in *Pension Benefit Guaranty Corporation v. LTV Corporation*, that:

> An example, after all, is just that: an illustration of a statute's operation in practice. It is not, as the Court of Appeals apparently thought, a definitive interpretation of a statute's scope. 496 U.S. 633, 649 (1990).

The notion that a corporation's return is a "return" only when the corporation actually has tax liability is also contrary to Respondent's own regulation. In September 1958 the Treasury proposed, and in February 1959 adopted, the Regulation section noted above that requires every corporation to make a

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[41] To the extent that legislative history is important, its language, as well as the language of the statute itself, should be given its plain meaning. An "example" is a particular case, incident, etc., *that is representative of a broader class*. An example is –

> [a] typical instance; a fact, incident, quotation, etc. that illustrates, or forms a particular case of, a general principle, rule, state of things, etc. . . . 5 Oxford English Dictionary 489 (2d ed. 1989).

It strains credibility that the drafters of the 1958 legislative history would have used the words "for example" if they had intended to describe the *only* application of the final sentence of Code §6037(a).

return of income *regardless of whether it has taxable income*.[42] This regulation, issued almost contemporaneously with the enactment of Section 6037(a) in 1958, strongly militates against giving an S corporation's return significance only when the S corporation has a tax liability.

The more logical view is that the legislative history provides merely *one example* of the purpose of the second sentence of section 6037(a): that section 6012 will control when a purported S corporation that has not validly elected subchapter S files an income tax return. The last sentence of the Senate Report merely illustrates the period of limitations treatment for an S corporation whose election is invalid. If a corporation invalidly elects to be an S corporation, it is treated as a C corporation. The last sentence contains no statement concerning a corporation that makes a valid S corporation election. The Second Circuit's conclusion by negative implication that the period does not also run for a validly-elected S corporation's income tax return from the date it files its return (as it does for a C corporation) requires a leap of faith, not logic.

Congress could, if it had wished, easily have accomplished the result suggested by the Second Circuit. Congress did not do so, however. Section 6037(a) simply does not contain the language of limitation that Respondent would read into the statute and legislative history.

The reliance of the court below on the legislative history's use of this *one example* of when the second sentence of section 6037(a) and section 6012 could trigger the running of the statute elevates the importance of what is merely one example and denies effect to the second sentence of section 6037(a) but for the exceptional case of an invalid election. Most importantly, it allows the example to swallow the whole statute and effectively to write section 6012(a)(2) and the second sentence of section 6037(a) out of the Code. *See, Kelley v. Commissioner*, 877 F.2d at 759.

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[42] Regulation §1.6037-1(c).

This was the mistake of the Tax Court in *Leonhart v. Commissioner*, 27 T.C.M. (CCH) 443 (1968), *aff'd per curiam*, 414 F.2d 749 (4th Cir 1969). The Tax Court looked to the language of the Senate Report but ignored the second sentence of section 6037(a) which provides that a return filed under section 6037(a) will be treated as a return filed under section 6012(a)(2). Section 6037(a) does not provide that the S corporation's income tax return will be treated as a "return" only if its election is invalid, nor does it differentiate an S corporation's return from a C corporation's return for purposes of section 6012(a)(2). Therefore, an S corporation's return, like a C corporation's return, must be treated as a return for purposes of the provisions of chapter 66, relating to limitations.

The Tax Court continued its myopia by relying on *Leonhart* in its decision in *Fehlhaber v. Commissioner*, 94 T.C. 863 (1990), and in adopting *Fehlhaber* in this case. There were no S corporation level taxes to be assessed in 1958 when 6037(a) was promulgated, in 1959 when Regulation section 1.6037-1(c) was promulgated, or in 1960 and 1961, the tax years at issue in *Leonhart*. Such taxes were enacted in 1966 and imposed beginning in 1967 and have continued, although modified, to the present.

In 1966, subchapter S was amended to include section 1378.[43] Since then, an S corporation has been a taxable entity. Section 1378 imposed a corporate level tax on validly-electing S corporations with respect to certain capital gains.[44] Although section 6037(a) predates this corporate level tax, it states with no modification that an S corporation must file a

[43] Small Business Corporations Act, Pub. L. 89-389, §2, 80 Stat. 111 (1966).

[44] Because these capital gains were so-called "preference" items under section 57 of the Code, an S corporation taxable under section 1378 might be subject to the "minimum tax" under sections 56 and 58(d)(2) of the Code then in effect. The Deficit Reduction Act of 1984, Pub. L. No. 98-369, §721(v), 98 Stat. 971, also amended subchapter S to include section 1375(d) which imposes a corporate level tax on those S corporations that have certain amounts of passive income; and, the Tax Reform Act of 1986, Pub. L. 99-514, §632(a), 100 Stat. 2275, imposed a corporate level tax on S corporation liquidations.

tax return and that this return will be treated for statute of limitation purposes as a return filed by the corporation under section 6012. The Second Circuit failed to consider adequately the relationship between the date of enactment of section 6037(a) and the later changes to subchapter S.

Respondent suggests [Brief in Response to Petitioner for Certiorari (hereinafter "Br. Resp.") 13-14], that its interpretation of the pre-1982 statute is supported by the 1982 amendments that plainly changed the rules in this area. No such conclusion can be drawn. In that year, Congress changed the audit procedures for both partnerships and S corporations, for the purpose of simplifying the procedures for entities having large numbers of members.[45] For example, Congress generally required such entities to designate members who will be responsible for dealing with the Service and provided special rules for the issuance of deficiency notices and related procedures. At the same time, Congress specified that, for the larger entities affected by the new legislation, an extension of time either by the entity (with respect to the entity as a whole), or by the individual partner or S corporation shareholder (with respect to that partner or shareholder only), would extend the applicable period of limitations.

No inference can be drawn from these changes that Congress, in the pre-1982 period, wished to treat subchapter S returns as Respondent argues or to equate subchapter S corporations and partnerships. The 1982 amendments made wholesale changes to the treatment of S corporations to make them generally more like partnerships. Most notably, Congress removed the general dependence of an S corporation shareholder's income on the "earnings and profits" of the corporation, and instead substituted a passthrough regime similar to

[45] In explaining its substantial rewriting of subchapter S rules in 1982, the Congressional committees described pre-1982 subchapter S as incorporating "modified corporate rules", H.R. Rep. No. 826, 97th Cong., 2d Sess. 6 (1982); S. Rep. No. 640, 97th Cong. 2d Sess. 6 (1982).

that applying to partnerships.[46] Congress fully recognized the significance of its actions in this regard. In the words of both the House and Senate reports:

> The committee believes that partnership-like rules which pass items of income and loss through to the corporation's shareholders, with distributions being generally a return of the shareholder's investment including previously taxed earnings, is a simpler and more rational taxing scheme than the modified corporate rules of present subchapter S. Therefore, the bill adopts a partnership approach which treats all items, including such items as depletion, foreign income, and fringe benefits generally like they are treated under the partnership provisions. H.R. Rep. No. 826, 97th Cong., 2d Sess. 6 (1982); S. Rep. No. 640, 97th Cong., 2d Sess. 6 (1982).

In short, while the 1982 legislation changed the rules for future years, it implied nothing about the past.[47] Nevertheless,

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[46] Although Congress moved much closer to a partnership model for subchapter S in 1982, Congress did not remove all dependence on corporate concepts. Earnings and profits, for example, continue to be significant in the taxation of those S corporations that have earnings and profits left over from years when they were not S corporations. *See especially* 26 U.S.C. §1368 (dealing with distributions from S corporations). As a general matter, however, the 1982 changes to subchapter S have rendered earnings and profits much less important.

[47] Respondent cites language from the 1982 legislative history that purports to describe prior law in a manner consistent with the views of respondent. Br. Resp. 13-14, *citing* H.R. Rep. No. 826, *supra*, at 24; S. Rep. No 640, *supra*, at 25. This 1982 language, of course, has no formal bearing on the interpretation of a statute that Congress enacted in 1958. "[T]he views of some Congressmen as to the construction of a statute adopted years before by another Congress have 'very little, if any, significance.' " *United States v. Clark*, 445 U.S. 23, 33 n.9 (1980), *quoting United States v. Southwestern Cable Co.*, 392 U.S. 157, 170 (1968), and *Rainwater v. United States*, 356 U.S. 590, 593 (1958). Congress' 1982 musings on the 1958 statute cannot represent "an authoritative interpretation of what the [earlier] statute meant . . . since it is the function of the courts and not the Legislature . . . to say what an enacted statute means." *Pierce v. Underwood*, 487 U.S. 552, 565-66 (1988). Congress, in 1982, may authoritatively have determined the place that section 6037(a) would occupy in its *new* statutory regime for S corporations, but Congress in 1982 cannot have decided the meaning of section 6037(a) for years *prior* to the effective date of the 1982 enactments.

the Tax Court in *Fehlhaber v. Commissioner*, 94 T.C. 863 (1990) (the opinion it adopted in this case) refers to the Subchapter S Revision Act of 1982[48] (hereinafter "Revision Act"), and looks at the legislative history of the Revision Act in its attempt to determine the meaning of earlier legislation. 94 T.C. at 867. It recites the following language from the Senate Report on the Revision Act explaining the legislation:

> Under present law, a taxpayer's individual tax liability is determined in proceedings between the Internal Revenue Service and the *individual* whose tax liability is in dispute. Thus, any issues involving the income or deductions of a subchapter S corporation are determined *separately* in administrative or judicial proceedings involving the individual shareholder whose tax liability is affected. Statutes of limitations apply at the individual level, based on the returns filed by the individual. The filing by the

Moreover, to the extent post-enactment legislative history is deemed at all important, the 1982 committee report language should be balanced against that used in more recent reports. H.R. 4210, the Tax Fairness and Economic Growth Bill of 1992, was passed by both Houses of Congress but vetoed by the President. The bill, at §4907, contained language that would have established, *for taxable years beginning after the date of enactment*, that the limitations period with respect to S corporation items was to be determined by reference to the return filed by the shareholder, not the corporation. The 1992 conference report contains the following language:

> The . . . bill clarifies that the return that starts the running of the statute of limitations for a taxpayer is the return of the taxpayer and not the return of another person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit. *The provision is not intended to create any inference as to the proper interpretation of present law.* [Emphasis added.]

H.R. Conf. Rept. No. 461, 102d Cong., 2d Sess. 637 (1992). The provision contained in §4907 of H.R. 4210 remains "alive" on Capitol Hill as an apparently noncontroversial measure, and appears likely to be included the next time Congress passes comprehensive tax legislation. *See* H.R. Rep. No. 631, 102d Cong., 2d Sess. 280 (June 30, 1992) (including the provision in legislation reported by the House Ways and Means Committee).

[48] Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669.

> corporation of its return does not affect the statute of limitations applicable to the shareholders (emphasis added).[49]

Even if reference to the legislative history of a later act is a valid source of support concerning the meaning of the earlier legislative history and statute, the Senate and House Reports supporting the Revision Act contain nothing that refutes the Petitioner's position. An S corporation's income tax return is to be treated, for purposes of statute of limitations, *separately* from the return of the S corporation's shareholders. Further, the period of limitations on the *individual* return of the shareholder is governed by section 6012(a)(1) and not by section 6012(a)(2).

The language from the 1982 legislative history supports the Petitioner's position that there are two separate administrative or judicial proceedings possible, at both corporate and shareholder levels, and that the Service needs to seek extensions at both levels if the statute of limitations is due to expire at either level. The statute of limitations at the individual level runs from the filing of the individual's income tax return; the statute of limitations at the S corporation level runs from the filing of the S corporation's return.

As the 1982 legislative history states, the income, deductions, and tax credits of an S corporation are determined separately from its shareholders. Thus, all the legislative history supports the clear language of the Code that a separate three-year statute of limitations applies to both an S corporation and its shareholder, and that the Service should obtain separate extensions[50] of the period of limitations from the S corporation and its shareholders.

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[49] S. Rep. No. 646, 97th Cong. 2d Sess. at 25, 1982-2 C.B. 718, 729. The House Ways and Means Committee Report is identical. H. Rep. No. 826, 97th Cong., 2d Sess. at 24, 1982-C.B. 730, 741.

[50] Code §6501(c)(4).

IV

FAIRNESS AND FINALITY DICTATE PETITIONER'S CONSTRUCTION OF SECTIONS 6501(a), 6037(a), AND 6012(a)(2).

An S corporation is a separate entity, independent of its shareholders. It prepares and files its own tax return, independent of its shareholders. It then transmits limited information about that return to its shareholders by sending each shareholder a Schedule K-1 (J.A. 43-52). The shareholder's Schedule K-1 states only the information that a shareholder needs to complete his or her income tax return with respect to S corporation items. It does not state other corporate level information. It does not, for example, state whether the S corporation has been taxed. It does not contain information to make it possible for the shareholder to determine whether a tax should have been imposed or to determine whether the election to be taxed as an S corporation was valid.[51]

In the view of the Second Circuit, however, in some cases the S corporation's income tax return determines the expiration of the period of limitations while in others it is the shareholder's income tax return that controls. This interpretation makes it difficult for a shareholder to determine whether

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[51] The circuit court adopted Respondent's argument that because the S corporation's income tax return does not contain relevant information about a shareholder, including filing status, exemptions, deductions, or income, losses, or credits from other sources that would allow the Service to determine the shareholder's income tax liability, the appropriate return for purposes of the running of the period of limitations is the shareholder's income tax return. *See, Fehlhaber v. Commissioner*, 954 F.2d 653, 655 (1992).

A C corporation's income tax return also does not contain any such information. Yet, Respondent does not assert that the filing of the income tax return of the shareholder of a C corporation begins the running of the period of limitations with respect to items on the C corporation's income tax return.

The Service is not prevented from adjusting all items of income, deductions, filing status, credits, etc. on the shareholder's individual income tax return, when the statute of limitations on the individual income tax return has not expired. It is only the items that are determined at the S corporation level that he may not adjust if the limitations period has closed at the corporate level. This is also true for the shareholder of a C corporation.

examination by the Service of the S corporation's income tax return is closed for any particular taxable year because the shareholder does not know which return controls the limitations period. The shareholder also would not know whether the period of limitations was open for amending his or her income tax return with respect to S corporation items.

If application of the statute of limitations to the S corporation's income tax return hinges on whether the S corporation is or is not taxed, a shareholder, who only obtains a K-1 form, will never be confident that the statute of limitations has run on the S corporation's income tax return. If the S corporation's income tax return reflects a tax, its statute of limitations controls until and unless in a later examination of the return, the Service determines, in fact, that no tax was owed. At that point, the shareholder's income tax return becomes the one relevant for limitations purposes.

If the S corporation's income tax return shows no tax due, however, the shareholder's income tax return controls, until and unless in a later examination, the Service determines that a tax was, in fact, owed by the corporation. At that point, the corporation's return becomes the one relevant for limitations purposes. The shareholder has no access to information enabling him or her to monitor these shifting circumstances. A shareholder may ask the corporation to keep him or her informed but cannot compel the corporation to do so.

A shareholder must be certain of which records are relevant to a later examination by the Service and can only be responsible for those in his or her own possession and control. The burden should not be placed on the taxpayer to retain records indefinitely or to attempt to insure that the S corporation maintains its records indefinitely. To contend, as the Second Circuit does, that in some cases the shareholder's income tax return controls the period of limitations makes the shareholder responsible for actions taken and conclusions drawn at the corporate level. This both ignores the separation of the entity and the shareholder and, in many cases, unfairly imputes corporate actions to the shareholder.

The shareholder has neither possession nor control over the records of the S corporation. Although a shareholder may

ask the corporation to retain the records, a shareholder has no power to compel the corporation to comply with the request. The Ninth Circuit stated:

> The shareholder can defend against such an adjustment only by resort to the corporations's books and records. The statute of limitations exists, in part, so that after some time persons can be confident that their affairs are closed and they can dispose of old records. An S corporation should be entitled to the same finality as others, yet if any of the shareholders has given an extension of the statute of limitations to the IRS the shareholder's ability to defend against the adjustment would depend upon whether the corporation has retained the records. *Kelley*, 877 F.2d at 758.

The circuit courts' view in *Fehlhaber, Green*, and this case is that expecting a shareholder to " 'take the necessary steps to ensure that the Corporation preserves the relevant records' " does "not constitute an overly oppressive task for the shareholder." *Green v. Commissioner*, 963 F.2d 783, 789 (5th Cir. 1992). The issue is not the degree of burden but the actual ability of a shareholder to compel a corporation to preserve records. The *Green* court noted that Mr. and Mrs. Brody[52] did not even know the names of other shareholders or the directors of the S corporations in which they owned stock. *Id.* at 785. Had they learned the identities of the officers, there is no basis for believing they could have forced the corporation to maintain corporate records or make them available. Shareholders do not control the entity as do the partners in a partnership. Shareholders can only request; they cannot compel the corporation to take or to refrain from taking action, including maintenance of corporate records.

Respondent seeks comfort in the broadly stated maxim that statutes of limitation should be applied narrowly against the government. Br. Resp. 8 n.5; *cf. Badaracco v. Commissioner*, 464 U.S. 386, 391-92 (1983). That maxim appears to have originated in rather old conceptions of the doctrine of

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[52] One of the taxpayers in the *Green* case.

sovereign immunity. *Cf. United States v. Whited & Wheless, Limited*, 246 U.S. 552 (1918). The only apparent recent occasion in which this court has cited the maxim is in *Badaracco*, a case that involved the special extended limitations period applicable to taxpayer fraud, a problem that is not involved in this case. Even if the maxim continues to have some general vitality, it should not be applied here to permit the government to negate the concept of finality and defeat the most natural reading of the statute.

In any event, if ancient maxims are to figure in this litigation, it should not be forgotten that "statutes of limitation are founded on sound policy. They are statutes of repose, and should not be evaded by a forced construction." *Pillow v. Roberts*, 54 U.S. (13 How.) 472, 477 (1851); *see generally* Douglas A. Kahn, *The Supreme Court's Misconstruction of a Procedural Statute – A Critique of the Court's Decision in Badaracco*, 82 Mich. L. Rev. 461, 475-76 (1983). In this case, the Second Circuit's reading of the statute plainly constitutes a "forced construction" incompatible with the statute's plain meaning. Moreover, the unfairness, uncertainty, and lack of finality that result from the Second Circuit's view are easily avoided with no prejudice to the Service. The Service has frequently obtained separate extensions of the statute of limitations from C corporations and their shareholders. There is no reason why the Service should not follow the same procedures for extensions from S corporations and their shareholders.

In fact, in this case, the Service sought and received an extension from the S corporation for the tax year ending November 30, 1980, as well as from Petitioner. In *Kelley*, where the facts are nearly identical to this case, the Service obtained extensions from both corporation and shareholder, 877 F.2d at 757. *See also, Jacobsson v. Commissioner*, 54 T.C.M. (CCH) 1043 (1987). The court in *Kelley* notes:

> [T]he Service can obtain an extension of the statute of limitations if it determines that it needs more time to determine the accuracy of the corporate return. A requirement that the Service obtain an extension of the statute of limitations from the S corporation serves to place the corporation on notice that it should retain the materials necessary to substantiate its return. *Kelley*, 877 F.2d at 758.

By seeking separate extensions from the S corporation and its shareholders in this and other cases, the Service has clearly demonstrated its understanding of the need for them. There is no reason to protect the Service from its own failure to secure in this case a corporate-level extension for the right corporate tax year, particularly when to do so is inequitable to the shareholder. The Service's failure should estop it from attempting to correct an omission by focusing on a different taxpayer.

Such estoppel will provide for consistency and allow taxpayers to rely on appropriate Service procedures in auditing S corporation returns. Judge Oakes pointed out in his concurring opinion in *Ogiony v. Commissioner*, 617 F.2d 14 (2d Cir. 1980), "[C]onsistency over time and uniformity of treatment among taxpayers are proper benchmarks from which to judge IRS actions." 617 F.2d at 18. *See also Sirbo Holding, Inc. v. Commissioner*, 476 F.2d 981, 987 (2d Cir. 1973).

Because the Service can easily obtain an extension, as it demonstrated in this case and in *Kelley* and *Jacobsson*, preventing the Service from making an adjustment to an S corporation's income tax return after the corporation's limitation's period has run will not prejudice or unduly burden the Service.

This Court stated in *Rothensies v. Electric Storage Battery Co.*:

> As statutes of limitation are applied in the field of taxation, the taxpayer sometimes gets advantages and at other times the Government gets them. Both hardships to the taxpayers and losses to the revenues may be pointed out. . . . They tempt the equity-minded judge to seek ways for relief in individual cases. 329 U.S. 296, 302 (1946) (footnote omitted).

In this case, equity weighs in favor of the taxpayer and this Court may implement that result without undermining the statute of limitations in tax matters.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

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In the Supreme Court of the United States

OCTOBER TERM, 1992

SHELDON B. BUFFERD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether, when a loss and an investment tax credit are erroneously reported on the return of a Subchapter S corporation, and those items "pass through" to the return of a shareholder (with whom an extension of the period of limitation has been duly executed), they may be disallowed on the shareholder's return *after* the limitations period for assessing tax against the corporation has expired.

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OPINIONS BELOW

The opinion of the court of appeals (J.A. 66-74) is reported at 952 F.2d 675. The opinion of the Tax Court (J.A. 57-61) is reported unofficially at 61 T.C.M. (CCH) 2410.

JURISDICTION

The judgment of the court of appeals was entered on January 3, 1992. The petition for a writ of certiorari was filed on March 10, 1992, and was granted on June 22, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. In 1979, petitioner was a shareholder of a qualified small business corporation known as Compo Financial Services, Inc. Under the provisions of Subchapter S of the Internal Revenue Code, items of income, loss and tax credits of a qualified small business corporation ordinarily "pass through" to the shareholders of the corporation and are reported on their individual income tax returns. See 26 U.S.C. 1366(a)-(c);[1] 3 B. Bittker & L. Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 95.6, at 95-89 to 95-114 (1991). The Subchapter S corporation is itself directly liable for tax in only a few, limited circumstances not involved in this case.[2] When items

[1] During the period involved in this case, the Subchapter S provisions were located at 26 U.S.C. 1371 *et seq.* (1976). These provisions were modified and renumbered as 26 U.S.C. 1361 *et seq.* by the Subchapter S Revision Act of 1982, Pub. L. No. 97-354, § 2, 96 Stat. 1669. The modification and reenactment of the Subchapter S provisions in 1982 did not affect the issue presented in this case.

[2] During the period relevant to this suit, a Subchapter S corporation was itself liable for tax only in limited circumstances. It was subject to a special tax imposed on certain of its long-term capital gains under 26 U.S.C. 1378 (1976). Such gains also could generate a "minimum tax" on the corporation under Sections 56 and 58(c)(2) as then in effect. See B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 6.07, at 6-22 to 6-25 (5th ed. 1987). Otherwise, however, so long as the corporation preserved its Subchapter S status, it was exempt from the regular income tax imposed on other corporations by Section 11, and its gains, losses, and credits were apportioned to its shareholders according to their respective stock interests. In that respect, the "pass through" treatment afforded a Subchapter S corporation and its shareholders resembles the treatment historically afforded to a partnership and its partners. See *United States* v. *Basye*, 410 U.S. 441, 448 n.8 (1973).

"pass through" to the shareholders, it is the shareholders (rather than the corporation) whose tax is affected by disallowance of erroneous items derived from the Subchapter S corporation. See *ibid.*

Under Section 6037 of the Code, Subchapter S corporations are required to file annual income tax returns that serve both (i) as "information returns," providing detailed information on income and deductions for the preparation of individual shareholder returns and (ii) as corporate returns in the limited situations when the corporation is itself liable for tax (see note 2, *supra*). See *Fehlhaber* v. *Commissioner*, 954 F.2d 653, 655 (11th Cir. 1992). Pursuant to Section 6037, the Subchapter S corporation (Compo) of which petitioner was a shareholder filed its 1979 return on February 1, 1980 (J.A. 38). On that return, Compo reported an erroneous loss deduction and tax credit that "passed through" to Compo's shareholders.[3] Petitioner reported his share of the erroneous loss and credit on his individual income tax return for 1979, which he filed on April 15, 1980 (J.A. 12, 14-15).

b. Section 6501(a) of the Internal Revenue Code generally requires that any assessment of income taxes be made by the Internal Revenue Service "within 3 years after the return was filed." 26 U.S.C. 6501(a).[4] This three-year limitations period may be

[3] Compo was a partner in a partnership named Printer Associates. The erroneous loss deduction and tax credit that Compo reported resulted from its participation in that partnership. See J.A. 14-15, 40.

[4] Section 6501(a) provides:

> Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed

extended by a written agreement signed by the Service and the taxpayer before the period expires. 26 U.S.C. 6501(c)(4). If the Service mails a notice of deficiency to a taxpayer while the assessment period is still open (by virtue of such an extension or otherwise), the time for assessment is tolled, and if the taxpayer timely seeks review of the deficiency in the Tax Court, the assessment period stays open until after the Tax Court's decision becomes final. 26 U.S.C. 6503(a)(1).

In March 1983, before the three-year period for assessing petitioner's 1979 taxes expired, petitioner and the Internal Revenue Service signed a consent to extend the period for assessment in accordance with Section 6501(c)(4) (J.A. 55-56).[5] In December 1987,

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within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

[5] The extension agreement applied, by its terms, to adjustments relating to "any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's tax return)" (J.A. 55-56). Presumably because the deficiency at issue (both currently and at the time the extension agreement was made) concerns Compo's treatment of partnership items (see note 3, *supra*), petitioner stipulated that the deficiency notice was timely under the extension agreement (J.A. 15). Petitioner did not contend in the Tax Court that the extension agreement was inapplicable to the partnership items reflected on Compo's and petitioner's returns. Petitioner also declined to raise such a contention in the court of appeals, "even after a request for additional briefing" on that issue was made by that court (J.A. 74). Since petitioner raised no objection, the court deemed the extension agreement "applicable to the income at issue here" (J.A. 73-74).

within the period so extended, the Service mailed petitioner a notice of deficiency. The notice asserted a deficiency in petitioner's individual income tax for 1979 based upon disallowance of his distributive share of the erroneous loss deduction and tax credit reported by Compo (J.A. 15-16).

2. Petitioner filed a timely Tax Court petition for review of the deficiency (J.A. 2-8). While not disputing that the assessment period applicable to his individual tax return remained open due to his extension agreement and petition to the Tax Court, petitioner claimed that the disallowance of the "pass through" items from the Subchapter S corporation was time-barred because the period for assessing a tax against that corporation had lapsed (J.A. 7).

Petitioner's contention was based upon Section 6037(a) of the Code, which provides that the statute of limitations for a return filed by a Subchapter S corporation is the same as for a return filed by an ordinary business corporation under Section 6012 of the Code. See 26 U.S.C. 6037(a). The return of Compo Financial for the period ending November 30, 1979, was filed on February 1, 1980 (J.A. 13-38). Because the adjustments to the erroneous deduction and tax credit that "passed through" to petitioner in this case did not create any tax liability for the Subchapter S corporation, and since that corporation was not liable for petitioner's individual income tax deficiencies resulting from inclusion of the erroneous Subchapter S corporation deductions and tax credits, the Service did not seek an extension of the limita-

tions period for assessing taxes against the corporation for 1979. The three-year period for making an assessment against the corporation for any taxes *it* owed under its 1979 return thus expired in February 1983, before the Service mailed a notice of deficiency to petitioner.

The Tax Court concluded that the period for assessing the deficiency in petitioner's taxes had not expired (J.A. 57-61). The court held that the period during which taxes may be assessed under Section 6501 "is measured with reference to the individual shareholder's income tax return, rather than the [Subchapter S] corporation's information return" (J.A. 61). In so ruling, the court followed its unanimous, reviewed decision in *Fehlhaber* v. *Commissioner*, 94 T.C. 863 (1990), aff'd, 954 F.2d 653 (11th Cir. 1992). The Tax Court acknowledged that its decisions in *Fehlhaber* and in this case were in conflict with *Kelley* v. *Commissioner*, 877 F.2d 756 (1989), where the Ninth Circuit held that "pass through" items from a Subchapter S corporation could not be disallowed on the return of an individual shareholder *after* the time for assessing tax against the corporation had expired. The Tax Court concluded that *Kelley* was wrongly decided and declined to apply it in cases not appealable to the Ninth Circuit (J.A. 61).

3. The Second Circuit affirmed (J.A. 66-74). The court of appeals concluded that, under the "clear and unambiguous" language of the statute, "[t]he relevant return for purposes of [S]ection 6501(a) is [petitioner's] return rather than Compo's S corporation return" (J.A. 72, 73). In the court's view, Sections 6037 and 6501 created no impediment to assessing petitioner for his personal tax deficiency produced by adjustments to his share of "pass through" items

derived from the Subchapter S corporation's return. The court explained that "[a]n adjustment to the return of an S corporation that does not impose tax liability on that S corporation is not barred by [S]ections 6501(a) and 6037" (J.A. 71). For this reason, the court of appeals expressly "disagree[d]" with the contrary decision of the Ninth Circuit in *Kelley* (*ibid.*).

SUMMARY OF ARGUMENT

Section 6501(a) of the Internal Revenue Code provides that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed." 26 U.S.C. 6501(a). Under the plain language of this statute, an assessment against a given taxpayer is not barred unless it is made more than three years after the filing of "the return" of the taxpayer against whom the tax is assessed. Since the taxes resulting from the income and deductions that "flow through" to the shareholder of a Subchapter S corporation are owed by the shareholder, and not by the corporation, the period for assessing the shareholder's taxes runs from the filing of *his* return. Before that period expired in this case, petitioner agreed to extend it in accordance with Section 6501(c)(4) of the Code. The notice of deficiency was mailed to petitioner within the period so extended and, therefore, within the time allowed by the statute.

It is irrelevant that the three-year period for assessing taxes that might be owed by the Subchapter S corporation had expired before the deficiency notice was issued to petitioner. The Subchapter S corporation is not itself liable for taxes on the income and deductions that "pass through" to its shareholders;

only the shareholders are liable for taxes on these items. Accordingly, there was no tax liability to be assessed on the corporation. Moreover, the income tax return of the Subchapter S corporation obviously does not contain sufficient information to compute the shareholders' tax liabilities, which depend not only on the "pass through" items from the Subchapter S corporation but also on income, deductions, and exemptions attributable to other sources.

The court of appeals correctly rejected petitioner's contention that Section 6037 of the Code requires a different conclusion. Under Section 6037, a Subchapter S corporation is required to file a return each year reporting the items that "pass through" to its shareholders and also reporting its tax liability in the limited situations when it is directly liable for tax. When the Subchapter S corporation is itself liable for tax, the period for assessing tax against the Subchapter S corporation runs from the date that its return is filed. Because the erroneous losses and credits reported by the Subchapter S corporation "pass through" to its shareholders, however, it is the shareholders—not the Subchapter S corporation—who are liable for taxes resulting from disallowance of the erroneous items. It is thus from the date that the shareholders' returns are filed—not the date that the corporation's return was filed—that the limitations period for assessment against the shareholders runs under Section 6501(a).

ARGUMENT

ERRORS IN REPORTING ITEMS OF INCOME ON THE RETURN OF A SUBCHAPTER S CORPORATION THAT "PASS THROUGH" TO THE RETURNS OF INDIVIDUAL SHAREHOLDERS MAY BE DISALLOWED ON THE SHAREHOLDERS' RETURNS REGARDLESS OF WHETHER THE LIMITATIONS PERIOD FOR ASSESSING TAX AGAINST THE CORPORATION HAS EXPIRED

Upon examination of petitioner's return, the Internal Revenue Service disallowed an erroneous loss deduction and tax credit that petitioner had claimed. The erroneous deduction and credit stemmed from the business conducted by a Subchapter S corporation. The Subchapter S corporation was not itself subject to tax on these items, which "passed through" directly to the individual returns of its shareholders, including petitioner. See pages 2-3, *supra*. Petitioner does not attempt to defend the erroneous deductions and credits and thus does not contest the merits of the proposed adjustments.

Instead, petitioner asserts that any assessment of the resulting deficiency in his taxes is barred by the statute of limitations because the period for assessing a tax against the Subchapter S corporation (which was not subject to tax on these items) had expired. In an opinion whose holding has since been joined by the Eleventh Circuit in *Fehlhaber* v. *Commissioner*, 954 F.2d 653 (1992), and by the Fifth Circuit in *Green* v. *Commissioner*, 963 F.2d 783 (1992), the court of appeals correctly concluded that expiration of the period for assessing tax against a Subchapter S corporation does not bar adjustment of the items of income or loss that "pass through" directly to the returns of the individual shareholders. The Commis-

sioner is therefore not barred from assessing the tax deficiency against petitioner in this case.

A. Under Section 6501 of the Internal Revenue Code, the Statute of Limitations for the Assessment of Income Taxes Commences Upon the Filing of "The Return" of the Taxpayer on Whom the Tax Is Imposed

1. The Commissioner of Internal Revenue is authorized to examine the return of every taxpayer to determine his "taxable income" (26 U.S.C. 1, 11) and to ensure the correct calculation of taxes due. See 26 U.S.C. 7601. If that examination reveals that additional taxes are owed, the Commissioner is to issue a "notice of deficiency" to the taxpayer and, ultimately, to enter an "assessment" of the taxes owed.[6] Once an "assessment" of the tax liability is made, the Commissioner may commence administrative and judicial procedures to collect the taxes due.[7] Section 6501(a) of the Internal Revenue Code provides, however, that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed" and that "no proceeding in court without assessment for the collection of such tax shall

[6] See 26 U.S.C. 6212(a) (notice of deficiency to be issued if a deficiency is determined), 6213(a) (assessment to be made after time to seek Tax Court review of notice of deficiency has expired or the Tax Court decision becomes final), 6215 (assessment of deficiency found by Tax Court). An "assessment" is made "by recording the liability of the taxpayer in the office of the Secretary" (26 U.S.C. 6203).

[7] See 26 U.S.C. 6303 (notice and demand for payment after assessment), 6321-6322 (lien for taxes arises after assessment), 6331 (administrative levy on property to collect taxes unpaid after demand following assessment), 7403 (civil action to enforce lien); 28 U.S.C. 1396 (civil action for collection of unpaid taxes).

be begun after the expiration of such period." 26 U.S.C. 6501(a).

The statute of limitations contained in Section 6501(a), by its terms, limits the time in which the Commissioner may make a valid assessment of taxes. But it does not operate to bar the Commissioner from making a correct determination of the taxpayer's "taxable income" *within the period provided*. In particular, in examining a return for the purpose of ensuring that it properly sets forth the taxpayer's "taxable income," the Commissioner is not required to accept the taxpayer's characterization of items of income or loss merely because those same items were characterized in the same manner on some other return (of the same or a different taxpayer) that is no longer subject to assessment. Section 1312 of the Code expressly recognizes that, in examining a current return, the Commissioner may determine that an item is to be included as income (or a deduction is to be denied) on that return *even though* that item was erroneously included as income (or was erroneously not claimed as a deduction) on a prior return of the taxpayer or a third party for whom the statute of limitations has expired. 26 U.S.C. 1312(1) and (4).[8] See also *Commissioner* v. *Munter*, 331 U.S. 210

[8] The Code recognizes that these and other similar adjustments could result in an unfair double tax if an item of income is found subject to tax on the current return and the prior return, on which the same item was erroneously reported as income, is no longer subject to correction. Sections 1311-1314, which are referred to as the "mitigation" provisions of the Code, alleviate the potential double tax that can occur when the error is corrected after "the ordinary period of limitations has run for [the earlier] year." M. Saltzman, *IRS Practice and Procedure* ¶ 5.07, at 5-33 (1981). In the present case, the disallowance of the improper deduc-

(1947) (shareholder's return adjusted to reflect item as dividend, rather than return of capital, based upon recalculation of corporation's accumulated earnings and profits); *Bull* v. *United States*, 295 U.S. 247, 252 (1935) (income tax recovered by Commissioner on items erroneously reported as subject to estate tax, even though the estate had paid the tax and the statute of limitations had expired on estate tax refund; estate permitted a credit for overpayment of estate tax against income tax found due); *Commissioner* v. *Goldwyn*, 175 F.2d 641 (9th Cir. 1949). See note 8, *supra*. As the court stated in *Leonhart* v. *Commissioner*, 414 F.2d 749 (4th Cir. 1969), errors in the return of a Subchapter S corporation do not justify a shareholder's failure to report and pay the proper tax on his income: the shareholder "can and should pay the amount of tax he owes on an accurate report of [his share of] corporate income." *Id.* at 750.

Since the statute of limitations on the "assessment" of taxes does not bar the Commissioner from making a correct determination of petitioner's "taxable income" within the time provided, the statute does not bar the assessment in this case. Under the plain language of the statute, an assessment is not barred unless it is made more than three years after the

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tion and credit on petitioner's return does not result in a double tax, for only petitioner is subject to tax on these items (since the Subchapter S corporation is not itself subject to tax). See page 2, *supra*. The "mitigation" provisions of the Code thus have no direct application to the tax at issue in this case.

For the same reasons, the doctrines of estoppel and set off are not applicable to this case. See M. Saltzman, *supra*, ¶ 5.06, at 5-26 to 5-31. These doctrines have potential application only when the Commissioner, "by using the statute of limitations, attempts to profit by inconsistency." *Id.* at 5-27.

filing of "the return" of the taxpayer against whom the tax is "imposed" (26 U.S.C. 6501(a)). See *Siben* v. *Commissioner*, 930 F.2d 1034, 1035 (2d Cir.), cert. denied, 112 S. Ct. 429 (1991). The tax in this case is "imposed" on petitioner, not on the Subchapter S corporation of which he is a shareholder. Indeed, *no* tax is imposed on the Subchapter S corporation, regardless of the erroneous loss deduction and tax credit that the corporation reported.[9] See 26 U.S.C. 1366(a)-(c); notes 2, 8, *supra*. The notice of deficiency reflecting the adjustments in petitioner's return was mailed within the period provided by Section 6501(a), as extended by agreement pursuant to Section 6501(c)(4) (J.A. 15, 74).[10] The court of appeals therefore correctly con-

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[9] Since the Subchapter S corporation is not the "taxpayer" whose "liability" is to be recorded "in the office of the Secretary" (26 U.S.C. 6203), there was no assessment to be entered on that corporation.

[10] In his brief on the merits in this Court (Br. 10), petitioner now contends for the first time that his agreement to extend the statute of limitations—which, by its terms, refers to adjustments in "partnership" items (J.A. 14, 74)—should not be interpreted to apply to adjustments to items relating to the Subchapter S corporation. As we have noted, petitioner did not raise this claim in either the Tax Court or the court of appeals. See note 5, *supra*. Indeed, petitioner declined to press such a contention in the court of appeals even *after* the court requested additional briefing from the parties on this very point (J.A. 74). Based upon petitioner's continued failure to assert such a claim, the court of appeals deemed the extension agreement applicable to adjustment of the items involved in this case (*ibid.*). This conclusion was especially appropriate since the deficiency at issue in this case arose from Compo's erroneous treatment of partnership items. See note 5, *supra*. In his petition for a writ of certiorari, petitioner also did not raise or address the claim that he now seeks to assert in his merits brief. In these circum-

cluded that the assessment of petitioner's taxes is not barred by the statute of limitations.

2. Petitioner nonetheless contends (Br. 14-15) that when a deficiency is attributable to an item that is "passed through" to an individual's return from a Subchapter S corporation, the relevant "return" that commences the running of the statute of limitations under Section 6501(a) should be the "return" of the corporation, rather than petitioner's individual return. That contention lacks any foundation.

Statutes of limitation that bar "the collection of taxes otherwise due and unpaid are strictly construed in favor of the Government." *Badaracco* v. *Commissioner*, 464 U.S. 386, 392 (1984) (quoting *Lucia* v. *United States*, 474 F.2d 565, 570 (5th Cir. 1973)). The income tax "return" referred to in Section 6501(a) is the document that provides the information necessary for the Internal Revenue Service to determine the taxpayer's correct income tax liability. See *Germantown Trust Co.* v. *Commissioner*, 309 U.S. 304, 309-310 (1940) (a fiduciary return filed by a trust company constituted the "return" for purposes of the assessment of a corporate tax because it "disclose[d] all of the data from which the [corporate] tax * * * can be computed"); *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219, 222-223 (1944) (timely filing or regular corporate return did *not* commence the running of the limitations period for assessment of the surtax on personal holding companies because

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stances, the Court consistently has held that it will "decline to consider [arguments raised] here for the first time." *Demarest* v. *Manspeaker*, 111 S. Ct. 599, 603 (1991). See also *DeShaney* v. *Winnebago County Dep't of Social Servs.*, 489 U.S. 189, 195 n.2 (1989); *Berkemer* v. *McCarty*, 468 U.S. 420, 443 & n.38 (1984).

the corporate returns "did not show the facts on which [surtax] liability would be predicated"). For this reason, in *Automobile Club* v. *Commissioner*, 353 U.S. 180 (1957), the Court held that informational filings that "lack the data necessary for the computation and assessment of deficiencies * * * are not therefore tax returns within the contemplation of [Section 6501(a)]." *Id.* at 188.

Under these decisions, the return filed by the Subchapter S corporation can not qualify as the "return" that commences the time for assessment of the taxes imposed on individual shareholders. The annual return made by a Subchapter S corporation pursuant to Section 6037 of the Code serves a dual function: (i) it is an "information return" that sets forth detailed information on income and deductions and shows "each shareholder's pro rata share of each item * * * for the taxable year" (26 U.S.C. 6037(a)) to assist in preparation of the individual shareholders' returns; and (ii) it serves as the corporate return reporting taxes owed by the Subchapter S corporation in the limited circumstances in which the corporation may itself be liable for tax. See *Green* v. *Commissioner*, 963 F.2d at 768-788; *Fehlhaber* v. *Commissioner*, 954 F.2d at 655; *Benderoff* v. *United States*, 398 F.2d 132 (8th Cir. 1968); note 2, *supra*. The information contained in a Subchapter S corporation return obviously does not contain all the "data necessary for the computation and assessment" (*Automobile Club* v. *Commissioner*, 353 U.S. at 188) of the taxes owed by an individual shareholder."

" Petitioner misconstrues the decision below in contending (Br. 16-18, 40-41, 44, 51) that the court of appeals held that a Subchapter S corporation's return is not a "return" for purposes of Section 6501 unless a tax is owed by the cor-

The return filed by Compo in this case contained no information relating to petitioner's income, losses or deductions from other sources. It did not indicate his filing status, exemptions or any of the other individualized information required for the calculation of his taxes.[12] Since the information on the Subchapter S return, like the information on a partnership return,[13] "does not furnish information necessary to calculate the individual['s] income tax," it can not "qualify as the 'return' under § 6501(a) to trigger the statute of limitations for assessment of individual income taxes" (*Siben* v. *Commissioner*, 930 F.2d at 1036). See also *Estate of Klein* v. *Commissioner*,

poration. If no tax is owed by the corporation, then there is nothing to assess and Section 6501 has no application. In the unusual circumstances when a tax is owed by a corporation, its return commences the running of the statute of limitations under Section 6501 with respect to the assessment of any "tax imposed" (26 U.S.C. 6501(a)) on the corporation. See *Fehlhaber* v. *Commissioner*, 954 F.2d at 656. But the return of the Subchapter S corporation cannot constitute the "return" with respect to the "tax imposed" on the shareholder because it does not contain sufficient information to determine the shareholder's liability for tax.

[12] Moreover, the return filed by Compo was for the period ending November 30, 1979, and thus did not even correspond to the same tax period as petitioner's individual return, which was for the year ending December 31, 1979. See J.A. 7, 13.

[13] See Eustice, *Subchapter S Corporations and Partnerships: A Search for the Pass Through Paradigm (Some Preliminary Proposals)*, 39 Tax L. Rev. 345, 346 (1984):

> Partnerships and now S corporations are the purest forms of pass through entity. They are treated as mere conduits; both undistributed income and losses flow through to their owners and have the same tax character in the owners' hands as they do at the entity level.

537 F.2d 701, 704 (2d Cir.), cert. denied, 429 U.S. 980 (1976); *Durovic* v. *Commissioner*, 487 F.2d 36, 40 (7th Cir. 1973) ("[t]he filing of an informational partnership return, upon which no assessment can be made within the meaning of 26 U.S.C. § 6501, could not begin the running of the statute of limitations"), cert. denied, 417 U.S. 919 (1974).

The court of appeals was therefore correct in concluding (J.A. 70-73) that the "return" for purposes of the statute of limitations on assessments in Section 6501(a) is that of the taxpayer whose liability is to be assessed and not that of the S corporation, whose return merely contains information on a few of the many items that give rise to the individual taxpayer's liability. Petitioner's contrary contention is not meaningfully different for present purposes from the frivolous suggestion that a W-2 statement filed by an employer that sets forth an employee's wage information constitutes the employee's "return" for purposes of Section 6501. The mere fact that information has been filed with the Service that is *relevant* to the calculation of petitioner's income tax liability does not somehow transform the document containing that information into petitioner's income tax return. See *Siben* v. *Commissioner*, 930 F.2d at 1035. Nor does it excuse petitioner from making "an accurate report" of his income, including the income he derives from the Subchapter S corporation. *Leonhart* v. *Commissioner*, 414 F.2d at 750.

B. Section 6037 of the Internal Revenue Code Does Not Allow the Return of the Subchapter S Corporation To Operate as the Return of Its Shareholders

Section 6037 of the Internal Revenue Code requires every Subchapter S corporation to file an annual re-

turn and states, in its last sentence, that "[a]ny return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under Section 6012." 26 U.S.C. 6037(a). Section 6012, in turn, is the general provision that requires "[e]very corporation subject to taxation" to file a return. 26 U.S.C. 6012(a)(2). The court of appeals correctly held that, under these provisions, when a Subchapter S corporation is itself "required to pay tax, "the filing of an S Corporation return triggers the limitations period for imposition of [the] direct tax against the S Corporation" (J.A. 72). Section 6037, however, has no application to the statute of limitations for assessment of taxes against the shareholders, for the income that "passes through to them is not "subject to taxation" (26 U.S.C. 6012(a)(2)) in the hands of the Subchapter S corporation. Accord, *Green* v. *Commissioner*, 963 F.2d at 790; *Fehlhaber* v. *Commissioner*, 954 F.2d at 656-657.

This carefully crafted statutory structure was nonetheless misinterpreted by the Ninth Circuit in *Kelley* v. *Commissioner*, 877 F.2d 756 (1989). There, the court concluded that Section 6037 should be understood to bar assessment of taxes against both the Subchapter S corporation *and* the shareholders when the three-year period from the filing of the corporate return has expired. The court stated that the scope of Section 6037 is ambiguous and that its interpretation of the statute is preferable because it protects the shareholders from the possibility that their individual liabilities would be assessed after the statute had run on the corporation and its "books and records" had been discarded. 877 F.2d at 758. This reasoning, however, conflicts with the text, the history and the purpose of the statute.

1. a. The language of Section 6037 does not state, or even suggest, that the return of the Subchapter S corporation is to be deemed the return of the individual shareholders for items of income for which the shareholders, rather than the corporation, are "subject to taxation" (26 U.S.C. 6012(a)(2)). Indeed, under this Court's decisions applying Section 6501, the Subchapter S corporation return cannot constitute the shareholder's "return" because the corporate return does not contain sufficient information to determine the shareholder's liability for tax. See pages 14-17, *supra*. By extending the statute to accomplish a result that the text neither requires nor supports, the *Kelley* decision violates the well-established principle that statutes of limitations barring the "collection of taxes otherwise due and unpaid" are to be strictly construed in favor of the Government" (*Badaracco* v. *Commissioner*, 464 U.S. at 392). See *Fehlhaber* v. *Commissioner*, 954 F.2d at 657.

For purposes of the statute of limitations, the Subchapter S return constitutes the return of the corporation when—like an ordinary business corporation—the Subchapter S corporation is "subject to taxation" (26 U.S.C. 6012(a)(2)). The legislative history of Section 6037 emphasizes this point (S. Rep. No. 1983, 85th Cong., 2d Sess. 226 (1958) (emphasis added)):

> Thus, for example, the period of limitation on assessment and collection of any corporate tax found to be due upon a subsequent determination that *the corporation was not entitled to the benefits of subchapter S*, will run from the date of filing of the return required under the new Section 6037.

If the Subchapter S election is invalid or the corporation otherwise does not qualify for "the benefits of

subchapter S" (*ibid.*),[14] the corporation will be "subject to taxation" (26 U.S.C. 6012(a)(2)) and the assessment of taxes *against it* must be made within three years of its return. Similarly, if a qualified Subchapter S corporation receives the specific types of income for which tax is imposed directly against the corporation (see note 2, *supra*), the period for assessment of that tax "will run from the date of filing of the return required under * * * Section 6037" (S. Rep. No. 1983, *supra*, at 226).[15]

As the Second Circuit concluded in this case (J.A. 71-72), however, Section 6037 has no bearing on the limitations period under Section 6501(a) for the assessment of tax for items of income that "pass through" to the individual shareholders of the Subchapter S corporation.[16] Since it is the shareholders,

[14] The qualification requirements for Subchapter S corporations are set forth at 26 U.S.C. 1361. See, *e.g.*, 26 U.S.C. 1361(b)(1) (corporation may have no more than 35 shareholders, all of whom are individuals and are not nonresident aliens); 26 U.S.C. 1361(b)(2) (certain types of corporations are ineligible).

[15] Petitioner is simply wrong in contending that the example provided in the legislative history would "swallow the whole statute" (Br. 52). The Subchapter S corporation is "subject to taxation" (26 U.S.C. 6012(a)(2)) not only when it is not properly qualified (the example given in the legislative history), but also when it earns certain types of income described in 26 U.S.C. 1378 (1976) and when it becomes subject to the "minimum tax." See note 2, *supra*.

[16] Petitioner errs (Br. 38-39) in seeking to draw support from *Siben* v. *Commissioner*, 930 F.2d at 1036-1037, in which the Second Circuit held that a partnership return does not commence the period for assessment of tax against the individual partners. In *Siben*, the court distinguished *Kelley*, noting that Section 6037 "relating to S corporations

rather than the corporation, who are liable for taxes on these "pass through" items, the statute of limitations for assessing taxes against the corporation is simply irrelevant. The Eleventh Circuit reached this same conclusion in *Fehlhaber* v. *Commissioner*, noting "[i]t is clear that the last sentence in Section 6037 does not apply to a subchapter S corporation unless its return establishes that the corporation owes a tax." 954 F.2d at 656. See also *Green* v. *Commissioner*, 963 F.2d at 789-790; *Leonhart* v. *Commissioner*, 27 T.C.M. (CCH) 443, 462 (1968), aff'd, 414 F.2d 749 (4th Cir. 1969) (under Section 6037, the filing of a Subchapter S return begins the period for assessing any tax against the corporation, but does not start the period for making adjustments to items of corporate income or deductions that "pass through" to the shareholders).

b. Congress expressly confirmed this understanding of Section 6037 in enacting the Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669. As part of that Act, Congress made the unified auditing provisions that had been established for partnerships by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), 26 U.S.C. 6221

has no counterpart in the partnership provisions" (930 F.2d at 1037). That distinction, however, merely recognizes that *even if Kelley* had properly interpreted Section 6037, that statute has no application to the partnerships that *Siben* involved. When, in this case, the Second Circuit found it necessary to address the effect of Section 6037, the court correctly held that "the 'return' that starts the running of the limitations period at issue is that of the taxpayer whose liability is being assessed, and not that of a third person or entity whose return might also report the transaction that gives rise to the liability." J.A. 70 (citing *Siben* v. *Commissioner*, 930 F.2d at 1035).

et seq., applicable to certain Subchapter S corporations for years after 1982. See 26 U.S.C. 6241-6245. The Act thus provides for unified treatment of Subchapter S items at the corporate level, rather than examining each shareholder's return separately. See *Fehlhaber* v. *Commissioner*, 954 F.2d at 657. Under regulations authorized by 26 U.S.C. 6231 that parallel TEFRA's statutory exception from the unified audit procedures for "small" partnerships that have ten or fewer partners (26 U.S.C. 6231(a)), however, the Service has specified that the unified procedures will *not* be applied to the vast majority of Subchapter S corporations (perhaps 95%) that have five or fewer shareholders. Temp. Reg. § 301.6241-1T(c)(2)(ii).[17] The new statute, in any event, applies only to tax years ending after 1982 (see Pub. L. No. 97-354, § 6, 96 Stat. 1697) and thus has no direct application to this case.

With respect to the limited situations to which the new Act does apply, the statute specifies that the period for assessing a shareholder's tax for items that "pass through" from a Subchapter S corporation begins on "the date on which the [corporation's] return for such taxable year was filed" (26 U.S.C. 6229(a)). See 26 U.S.C. 6244. Congress recognized that this new approach—commencing the statute of limitations for assessment of tax imposed against *individuals* with the filing of the *corporate* return—represents a significant departure from the prior law

[17] Since the vast majority of Subchapter S corporations have five or fewer shareholders and will therefore not be subject to the provisions of the new statute, the question presented in this case remains of substantial continuing importance.

that is applicable in this case (S. Rep. No. 640, 97th Cong., 2d Sess. 25 (1982) (emphasis added):

> *Under present law*, a taxpayer's individual tax liability is determined in proceedings between the Internal Revenue Service and the individual whose tax liability is in dispute. Thus, any issues involving the income or deductions of a subchapter S corporation are determined separately in administrative or judicial proceedings involving the individual shareholder whose tax liability is affected. Statutes of limitations apply at the individual level, based on the returns filed by the individual. *The filing by the corporation of its return does not affect the statute of limitations applicable to the shareholders.*

The description of "present law" that Congress provided in enacting these related, intertwining modifications to this statutory scheme is "entitled to significant weight." *Seatrain Shipbuilding Corp.* v. *Shell Oil Co.*, 444 U.S. 572, 596 (1980); *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969).[18] Petitioner's assertion that the period for adjustment of items of income and deductions that "pass through" to an individual from a Subchapter S Corporation

[18] This is not a case in which the views of a subsequent Congress form a "hazardous basis" (*Russello* v. *United States*, 464 U.S. 16, 26 (1983)) for inferring the meaning of legislation enacted in a prior Session. In enacting intertwining amendments to a statutory scheme based upon a reasonable explanation of existing legislation, the views of the subsequent Congress as to that existing law are expressed in the performance of its legislative function, reflect a particularly well informed understanding of that legislation, and are entitled to great deference. See *Seatrain Shipbuilding Corp.* v. *Shell Oil Co.*, 444 U.S. at 596; *NLRB* v. *Bell Aerospace Co.*, 416 U.S. 267, 275 & n.8 (1974) (citing cases).

that is *not* subject to the provisions of the new Act commences upon the filing by the corporation of its return (Br. 8) conflicts directly with this legislative explanation of "present law." Petitioner's argument thus rests upon the untenable contention that Congress enacted a nullity in establishing new periods of limitation for "pass through" items from a limited category of Subchapter S corporations and that Sections 6229(a) and 6244 were therefore simply unnecessary. See *Fehlhaber* v. *Commissioner*, 954 F.2d at 656-657.[19]

2. The court of appeals also correctly rejected the suggestion of the *Kelley* court that a shareholder of a Subchapter S corporation is powerless to take protective steps to ensure the preservation of corporate records needed to support "pass through" items claimed on the shareholder's return (J.A. 72 (citing *Siben* v. *Commissioner*, 930 F.2d at 1037)). As the Eleventh Circuit explained in rejecting these "policy" concerns of the *Kelley* court, (i) a construction of Sections 6037 and 6501 that seeks to avoid unfairness to taxpayers conflicts with the court's overriding duty strictly to interpret statutes of limitations that bar the rights of the government to collect taxes otherwise due; (ii) an individual's income tax return is frequently dependent on records maintained by another entity, such as a partnership or trust; and (iii) Subchapter S corporations are, by definition (Section

[19] See also *West Virginia Univ. Hosps., Inc.* v. *Casey*, 111 S. Ct. 1138, 1148 (1991) ("Where a statutory term presented to us for the first time is ambiguous, we construe it to contain that permissible meaning which fits most logically and comfortably into the body of both previously *and subsequently* enacted law.") (emphasis added).

1371(a)(1)), owned and operated by a relatively small number of shareholders who have control of and access to the corporation's books.[20] *Fehlhaber* v. *Commissioner*, 954 F.2d at 657-658. See also *Green* v. *Commissioner*, 963 F.2d at 789.

Petitioner served as the Secretary and Treasurer of Compo (J.A. 14). There is thus no basis for petitioner to suggest that he was unable to take any steps he may have thought necessary to preserve Compo's records concerning the erroneous items that "passed through" to his individual return. Petitioner's concern with hypothetical situations in which a taxpayer may have difficulty obtaining corporate records (Br. 32) cannot be a basis for excusing his liability for tax. As the Fifth Circuit noted in rejecting this same argument in *Green* v. *Commissioner*, even if the limitations period commenced with the filing of the Subchapter S return, neither the court nor the shareholder could guarantee that the corporation would faithfully preserve its records until the limitations period expired. 963 F.2d at 789. Moreover, as the Eleventh Circuit explained in *Fehlhaber* v. *Commissioner*, 954 F.2d at 658, "the perceived unfairness to the taxpayer * * * is largely a matter of expecta-

[20] For the years in question, a qualifying "small business corporation" could not have more than 5 shareholders. Code Section 1371(a)(1) (1976). Under regulations authorized by Congress as part of the Subchapter S Revision Act of 1982 (26 U.S.C. 6241), the unified audit procedures of the Act are not applicable to Subchapter S corporations that have five or fewer shareholders. See Temp. Reg. § 301.6241-1T(c)(2)(ii). Moreover, each Subchapter S corporation is required to furnish its shareholders a copy of the information shown on the corporate return at their request. 26 U.S.C. 6037(b).

tions." Since the Service has taken a consistent position on this issue at all times, "both taxpayers and S corporations have been on notice that corporate records must be kept for more than three years after the information return is filed." *Ibid.*

In any event, as this Court stated in interpreting Section 6501 in *Badaracco* v. *Commissioner*, "[c]ourts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement." 464 U.S. at 398. "This is especially so when courts construe a statute of limitations, which 'must receive a strict construction in favor of the Government.'" *Ibid.* (quoting *E.I. du Pont de Nemours & Co.* v. *Davis*, 264 U.S. 456, 462 (1924)).

Reduced to its essence, petitioner's argument is that he should be subject to *two* different statutes of limitations for each of his tax years—one for his S corporation items and one for the rest of his tax return. This suggestion stems from petitioner's erroneous assumption that, when the Service adjusts the "pass through" items on a shareholder's return and assesses the resulting tax against the shareholder, it is somehow impermissibly adjusting the corporate return as to which the limitations period has expired. But the adjustments and the resulting assessments were made on the shareholder's return, not on the corporation's; the income involved is the shareholder's income, not the corporation's; and the "tax imposed" (26 U.S.C. 6501(a)) is on the individual, not the corporation. It is, of course, true that the corporate return provided information that was relevant to the examination of the shareholder's return. But the statute of limitations upon the "assessment" of petitioner's taxes does not prevent the Service from considering all relevant information, whatever its source, in making a correct determination of petitioner's taxable income within the period provided.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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SEPTEMBER 1992

☆ U. S. GOVERNMENT PRINTING OFFICE: 1992 312324 60044

No. 91-7804

In The

Supreme Court of the United States

October Term, 1992

SHELDON B. BUFFERD,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Second Circuit

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QUESTION PRESENTED

Whether the statute of limitations bars adjustments to Petitioner's income tax return with respect to items arising from an S corporation's income tax return?

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ARGUMENT

I. RESPONDENT'S CENTRAL ARGUMENT IS FLAWED BY A CHRONOLOGICAL ERROR WITH RESPECT TO THE ENACTMENT OF SECTIONS 6037 AND 1378 OF THE CODE.

At the heart of Respondent's argument (R. Br. 15) is a newly-created legal theory: that Congress intended that a Form 1120S, annual income tax return of an S corporation, have two separate and distinct functions. In fact, Respondent's argument creates for the return a "split-personality," with each function or "personality" having a different period of limitations. There is no language in the statute or legislative history that refers to this dual function for the income tax return of an S corporation.

Respondent asserts that the first function or "personality" of Form 1120S is as "an 'information return' that sets forth detailed information on income and deductions and shows 'each shareholder's pro rata share of each item . . . for the taxable year' (26 U.S.C. 6037(a)) to assist in preparation of the individual shareholders' returns;. . . . " (R. Br. 15). Congress did not add the language "each shareholder's pro rata share of each item- . . . for the taxable year" in Respondent's quotation until three years after 1979[1], the year at issue in this case. After quoting language of a statute that is inapplicable to the year at issue, Respondent argues that this so-called information function does not have and never has had a period of limitations because the Commissioner could

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[1] Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669.

never "assess" a tax on that "personality." There is no doubt that since enactment in 1958[2], the *first sentence* of section 6037[3] requires every S corporation to file an annual return containing the information requested on Form 1120S. But there is also no doubt that the *second sentence* of section 6037, also enacted in 1958, states: "*Any return* filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as *a return filed by the corporation* under section 6012" (emphasis added). Thus, Congress contemplated in 1958 that the Form 1120S would be subject to a period of limitations exactly like the period to which any other corporate return filed pursuant to section 6012 would be subject. Section 6501(a) provides that period of limitations: three years from the date of filing the return.

Respondent asserts that the second function or "personality" of Form 1120S is "as the corporate return reporting taxes owed by the Subchapter S corporation in the limited circumstances in which the corporation may itself be liable for tax." (R. Br. 15). It was not until 1966, however, eight years after Congress enacted section 6037, that it added section 1378 to the Code.[4] Therefore, it was not until eight years after it enacted section 6037 that Congress first imposed a tax on an S corporation. Thus,

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[2] Technical Amendments Act of 1958, Pub. L. No. 85-866, § 64(c), 72 Stat. 1606, 1650-56.

[3] Unless otherwise indicated, all section references in this brief are to the Internal Revenue Code of 1954, 26 U.S.C. § 1 *et. seq.*, as in effect for 1979, the year at issue.

[4] Small Business Corporations Act, Pub. L. No. 89-389, § 2, 80 Stat. 111, 113-14 (1966).

from 1958 to 1966, the Form 1120S could have no second function or "personality."[5] Respondent argues in effect that from 1958 until 1966, section 6501(a) and the *second sentence* of section 6037 provided a period of limitations for a second function or "personality" that did not exist.

In 1958, the only circumstance that could cause an S corporation to be taxed was a failure to qualify for the benefits of subchapter S. In that case, the corporation would file a regular C corporation return. Therefore, Respondent's theory regarding the 1958 legislation and legislative history ascribes to Congress an intent in 1958 to impose a corporate income tax on an S corporation eight years later.

There was no language in section 1378, no amendment to section 6037 in 1966, and no language in the 1966 Committee Report[6] that indicated that Congress intended to create two distinct and separate functions and two different periods of limitations for the return that the *first sentence* of section 6037 required an S corporation to file. In fact, there is also no evidence that Congress contemplated in 1966 that the new tax imposed would be reported on the same Form 1120S return required by section 6037. Respondent's chronological error in interpreting section 1378 and the *second sentence* of section

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[5] Respondent's view renders Congress' inclusion of the *second sentence* of section 6037 mere surplusage from enactment of section 6037 in 1958 until Congress first imposed an S corporation level tax eight years later.

[6] S. Rep. No. 1007, 89th Cong., 2d Sess., 706, 711-13, reprinted in 1966 U.S. Code Cong. & Admin. News 2141, 2146-48.

6037, as if they were enacted at the same time, renders the *second sentence* of section 6037 meaningless between 1958 and 1966.

Respondent reaches this illogical result (as did the Second Circuit below) by attempting to analogize the income tax return of an S corporation to the return of a partnership, rather than to the return of a C Corporation. Although section 6031 requires a partnership to file a return that contains information similar to that required by the *first sentence* of section 6037 for an S corporation, section 6031 does not contain a second sentence similar to the *second sentence* of section 6037. The mistaken analogy, between an S corporation and a partnership, permitted the courts below to hold and Respondent to argue that the Second Circuit's holding in *Siben v. Commissioner*, 930 F. 2d 1034, *cert. denied*, 112 S.Ct. 429 (1991), relating to a partnership return, is controlling in this case. (*See*, P. Br. 25-30).

Respondent has sought to ignore the plain meaning of sections 6501(a), 6037(a), and 6012 and to look instead to the legislative history. Petitioner believes the Code is clear. Moreover, Respondent's interpretation of the example (quoted P. Br. 36) in the 1958 legislative history of section 6037 would swallow the whole statute and effectively write section 6012(a)(2) and the *second sentence* of section 6037(a) out of the Code. In 1958 there was no corporate level tax on an S corporation. In 1958, a determination that the corporation was not entitled to the benefits of subchapter S was the *only* occasion on which an S corporation could itself be subject to tax.

Respondent's retort (R. Br. 20, n.15) again ignores the chronology: Congress enacted the *second sentence* of section 6037(a) in 1958[7] and section 1378 in 1966.[8] In the footnote, Respondent asserts in response to Petitioner's interpretation of the example in the 1958 legislative history that the S corporation is subject to taxation "when it earns certain types of income described in 26 U.S.C. 1378 (1976) and when it becomes subject to the 'minimum tax.'." An S corporation did not become subject to these taxes under section 1378 until 1966; yet, Respondent argues that this tax is relevant in interpreting Congressional intent in 1958. When the example was written in 1958 there was no tax imposed against an S corporation and the *only* time an S corporation was subject to taxation was when it failed to qualify under subchapter S. Thus, Respondent has failed to refute Petitioner's contention that Respondent's interpretation of the example in the 1958 legislative history swallows the whole statute and literally repeals section 6012(a)(2) and the *second sentence* of section 6037.

Rather than Respondent's doubtful, strained interpretation of these interrelated statutory provisions, this Court must interpret the clear and unambiguous language of sections 6501(a), 6037(a), and 6012(a)(2) of the Code and their legislative history in a manner which supports Petitioner's position. Those provisions reveal Congressional intent that the statute of limitations runs

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[7] Technical Amendments Act of 1958, Pub. L. No. 85-866, § 64(c), 72 Stat. 1606, 1656.

[8] Small Business Corporations Act, Pub. L. No. 89-389, § 2, 80 Stat. 111, 113-14 (1966).

from the date the S corporation files its S corporation return (Form 1120S).[9] Therefore, for the Commissioner to adjust any items on the S corporation's return, the Commissioner must complete the adjustments within the three-year period of limitations provided by section 6501(a) for that return. This is true whether the adjustments would result in an assessment of tax liability against the S corporation itself or against another person whose income tax return is affected by the adjustments.

Respondent quotes from this Court's opinion in *Badaracco v. Commissioner*, 464 U.S. 386 (1983) (R. Br. 26) that "[c]ourts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement." 464 U.S. at 398. Despite its own recitation of this rule, Respondent seeks to add additional language to both sections 6501(a) and 6037(a). Respondent argues (R. Br. 13) that section 6501(a) contains the language "against

[9] Respondent cites (R. Br. 14-15) *Germantown Trust Co. v. Commissioner*, 309 U.S. 304, 309-310 (1940) and *Commissioner v. Lane-Wells Co.*, 321 U.S. 219, 222-224 (1944) in an attempt to undermine the significance of an S corporation return as a return that may trigger the running of the limitations period under section 6501(a). Those cases focus on whether the information filed by a taxpayer who filed the wrong return or failed to file an additional required return was sufficient to constitute a "return" that would trigger the applicable limitations period. Those cases are inapposite to the case before this Court.

In this case, both the S corporation and its shareholder filed complete and timely income tax returns on Respondent's own tax forms. Respondent had adequate information for the applicable statute of limitations rules to apply. Respondent had the foresight to obtain an extension of the statute of limitations for Petitioner's income tax return, but failed to obtain such an extension for the S corporation's income tax return.

whom the tax is imposed" even though section 6501(a) contains no such language. Respondent then argues (R. Br. 18) that the *second sentence* of section 6037 contains the phrase "required to pay tax" after the word corporation even though section 6037 contains no such language. Without these additional phrases, the Second Circuit's (J.A. 72) view that an S corporation's period of limitations is only triggered if the S corporation itself is "required to pay tax" is unfounded. Thus, Respondent ignores its own cited quotation from *Badaracco* and requests that this Court add the words "against whom the tax is imposed" to section 6501(a) and the words "required to pay tax" to the *second sentence* of section 6037.

Petitioner recognizes that this Court, in interpreting section 6501(a) in *Badaracco*, held that courts should strictly construe statute of limitation provisions in favor of the government. But Petitioner is sure that this Court did not mean to accomplish this strict construction through the addition of words or phrases not present in the statute. Nor could this Court have intended its prescription to mean that whenever there is a statute of limitations issue, the government wins.

II. PETITIONER'S AGREEMENT TO EXTEND THE PERIOD OF LIMITATIONS DID NOT INCLUDE S CORPORATION ITEMS.

Respondent correctly notes that Petitioner's agreement to extend the statute of limitations (Form 872-A, J.A. 5) for 1979 "applied, by its terms, to adjustments relating

to 'any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's return).' " (R. Br. 4, n.5).

The agreement applied only to Petitioner's "distributive share" of partnership items or items from an entity that Petitioner treated as a partnership on his tax return. (J.A. 55-56). Petitioner was a partner in the partnership, Printer Associates, and he reported his distributive share of Printer Associates' items on his tax return. Petitioner was also a shareholder of Compo Financial Services, Inc., an S corporation. Compo was also a partner in Printer Associates.

The Commissioner's disallowance of Petitioner's distributive share of Printer Associates' partnership items is not, however, at issue in this case. Rather, this case concerns the Commissioner's disallowance of items arising from Petitioner's interest as a shareholder in Compo. Respondent contends that "the deficiency at issue in this case arose from Compo's erroneous treatment of partnership items." (R. Br. 13, n.10). That is irrelevant. The limitation contained in the extension agreement permitted a deficiency assessment only for adjustments to Petitioner's "distributive share" of partnership items or items from any organization treated by Petitioner as a partnership on his tax return. Compo was not a partnership.[10]

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[10] The statutory term "distributive share" is a term that applies only to partnerships and describes a partner's share of items of partnership income, gain, loss, deduction or credit. *See*, sections 702 and 704. S corporation shareholders, during the year at issue in this case, on the other hand, reported their "pro rata" shares of the corporation's undistributed taxable income and net operating loss. *See*, sections 1373 and 1374. The difference in statutory terminology stemmed from the recognition that a partnership was a more flexible business vehicle and partners may have had varying interests in different partnership items of income, gain, loss, deduction, or credit in accordance with the agreement of the partners. Shareholders had no flexibility in assigning their interests in corporate items of income, gain, loss, deduction, or credit; their interests were determined solely in accordance with their percentage stock ownership.

Nor did Petitioner ever treat any item arising from his interest in Compo as a partnership item. Therefore, Respondent cannot reasonably conclude that Petitioner stipulated that the deficiency notice was timely "because the deficiency at issue (both currently and at the time the extension agreement was made) concerns Compo's treatment of partnership items. . . . " (R. Br. 4, n.5). While it is true that Petitioner failed to contend in the Tax Court that the extension agreement was inapplicable to the partnership items, the Second Circuit declined to rule on whether Petitioner had waived his right to raise this issue. (J.A. 74).

Respondent's suggestion that Petitioner's Tax Court stipulations numbered 19 and 22 (J.A. 15) were somehow motivated by Compo's treatment of partnership items is unsupported by even a scintilla of evidence in the record. Rather, Petitioner's stipulation 22, that the deficiency notice was timely, incorporated by reference stipulation 19, which included the Form 872-A extension agreement as an attachment. That agreement clearly and specifically limited Respondent's ability to adjust items other than the limited class of items arising from an interest in a

partnership or an entity treated by the taxpayer on his return as a partnership. Therefore, stipulation 22 was limited by the terms of the Form 872-A and the notice of deficiency could be timely only with respect to the limited class of items arising from a partnership or from an entity treated by the taxpayer as a partnership on his tax return.

Respondent and Petitioner must both agree on the meaning of a stipulation or there is no meeting of the minds. If both Respondent and Petitioner did not agree on the limited nature of this stipulation 22, the stipulation should either be disregarded (*Stamos v. Commissioner*, 87 T.C. 1451 (1986)), or the case should be remanded to the lower courts for a determination of the limits of the stipulation. *See, The South Bay Corp. v. Commissioner*, 345 F.2d 698, 707 (2d Cir. 1965). As the Tax Court stated in *Stamos:* "Where language in a stipulation is so ambiguous that the intent of the parties cannot be discerned, the language in question will be disregarded, and the court will not construe a stipulation to exist where the parties have not clearly set forth the substance of what they have agreed to." 87 T.C. at 1455.

Respondent is mistaken in asserting that the Second Circuit foreclosed consideration of the effect of this limitation in the extension agreement. The Second Circuit noted that the printed Form 872-A contained a typewritten provision limiting any deficiency assessment to one resulting from an adjustment to Petitioner's distributive share from, basis in, or sale of any interest in "any partnership (or any organization treated by the taxpayer as a

partnership on the taxpayer's return)." (J.A. 73). The Second Circuit went on to note that Compo Financial Services, Inc. was not a partnership and that the taxpayer did not treat it as a partnership on his 1979 income tax return. (J.A. 73-74). Therefore, the extension granted the Commissioner by Bufferd did not by its terms reach the assessment of taxes resulting from an adjustment to S corporation items on Bufferd's income tax return.

Although the Second Circuit noted that Bufferd might have waived this theory by failing to make it before the Tax Court, the court observed: "Because of these considerations, and because Bufferd did not press this argument on appeal, even after a request for additional briefing on the issue by this Court, *we do not reach that issue.*" (J.A. 74) (emphasis added).

Thus, the Second Circuit considered but did not rule on whether the taxpayer had waived his right to make this argument as a result of his failure to brief and argue the meaning of the limitation in the courts below. *See, Stevens v. Department of the Treasury*, 111 S.Ct. 1562, 1567 (1991). In the interest of justice, however, this Court is free to consider the issue. *See, Youakim v. Miller*, 425 U.S. 231, 234 (1976); *and Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 111 S.Ct. 905, 910 (1991).

CONCLUSION

For the foregoing reasons, Petitioner requests this Court to reverse the judgment of the Court of Appeals or grant such other relief as the Court deems appropriate.

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October 1992

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On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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NO. 91-7804

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

SHELDON B. BUFFERD,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the
United States Court of Appeals
for the Second Circuit

BRIEF FOR *AMICI CURIAE* CHARLES T. GREEN AND KAY E. GREEN, *ET AL.*, IN SUPPORT OF PETITIONER

STATEMENT OF INTEREST OF *AMICI CURIAE*

Amici curiae are the Petitioners-Appellants in *Charles T. Green and Kay E. Green, et al. v. Commissioner*, 963 F.2d 783 (5th Cir. Consolidated No. 90-4629, June 22, 1992). *Amici curiae* were minority shareholders in electing small business corporations (until 1983, referred to as

"Subchapter S corporations").[1] These shareholders claimed deductions on their Forms 1040 for their pro rata share of losses reported by the Subchapter S corporations in 1977, 1978 and 1979. At the request of the Internal Revenue Service ("IRS"), each of *amici curiae* signed extensions of the three-year statute of limitations on assessment of additional tax for those years; no such extensions were signed by the Subchapter S corporations whose losses were reported on the individual tax returns of *amici curiae*.

After the IRS issued notices of deficiency claiming additional income tax from *amici curiae*, they each timely petitioned the United States Tax Court for a redetermination of the tax alleged to be due. Certain of the cases of *amici curiae* were tried on fully stipulated facts which presented only one issue of law to the Tax Court: whether that court would adhere to its decision in *Kelley v. Commissioner*, T.C. Memo 1986-405, in light of the reversal of that decision by the Ninth Circuit Court of Appeals. 877 F.2d 756 (1989). The Tax Court refused to follow the Ninth Circuit (*Brody v. Commissioner*, T.C. Memo 1991-78), and these *amici curiae* appealed to the Fifth Circuit.[2]

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1 After the effective date of the Subchapter S Revision Act of 1982, P.L. 97-354, 96 Stat. 1669, the electing small business corporations which had been commonly known as "Subchapter S corporations" became designated by statute as "S corporations." 26 U.S.C. Section 1361(a)(2), Internal Revenue Code of 1986, as amended.

2 In addition to Mr. and Mrs. Green, *amici curiae* include Robert White and Jean R. White (Nos. 90-4630 and 90-4631), Gene C. Elkins and Louise Elkins (No.90-4632), R.Talley Melton and Carolyn Melton (No. 90-4847), Bobby L. Davis and Ramona A. Davis (No.90-4849), James R. Graves and Elizabeth J. Graves (No. 90-4850), Don C. Quast and Audrey N. Quast (No. 90-4851), Elizabeth C. Mayfield (No. 90-4852), Jack E. Blanco and Jeanne Blanco (No. 90-4853), and Martin Brody and Jerrilyn Brody (No. 90-91-4497). Norman C. Way and Mary K. Way (No. 90-4848) and Mike Kane and Sandra Ann Kane (No. 90-4881), who were parties in the *Green* case in the Fifth Circuit, are not included herein as *amici curiae*. By stipulation in the United States Tax Court, the decisions in ten additional cases were not appealed to the Fifth Circuit but are tied to the outcome of the *Brody* case.

In Consolidated Docket No. 90-4629, 963 F.2d 783 (5th Cir. 1992), the Fifth Circuit declined to follow the *Kelley* decision of the Ninth Circuit, holding instead that the three-year statute of limitations applicable to assessments of additional income tax attributable to his or her investment in a Subchapter S corporation is the three-year statute of limitations pertaining to the individual's return, not the return of the Subchapter S corporation.[3] On the same day that the Fifth Circuit issued its opinion, this Court granted certiorari with respect to the Second Circuit's identical conclusion as to this statute of limitations question. *Bufferd v. Commissioner*, 952 F.2d 675 (2d Cir.), *cert. granted*, _ U.S.__, 112 S. Ct. 2990 (1992)(No. 91-7804). Since the

3 The balance of the *amici curiae* had Tax Court decisions entered against them based upon a common settlement offer made by the Commissioner of Internal Revenue. More than 90 days after those decisions were entered, these *amici curiae* filed motions for leave to file motions to vacate the decisions, based upon the holding of the Ninth Circuit in *Kelley*. The Tax Court denied the motions, ruling that in the absence of any allegations of fraud on the court, it had no jurisdiction to vacate otherwise final decisions. These *amici curiae* also appealed to the Fifth Circuit. Because the Fifth Circuit ruled against *amici curiae* with respect to the statute of limitations issue, it did not reach the issue regarding whether, in the absence of fraud on the court, the Tax Court had jurisdiction to vacate a decision more than 90 days after entry. The position of *amici curiae* was that the jurisdictional issue is controlled by the Fifth Circuit's prior holding in *La Floridienne J. Buttgenbach & Co. v. Commissioner*, 63 F.2d 630 (5th Cir. 1933).

controlling issue in the cases of *amici curiae* is identical to that in ***Bufferd***, *amici curiae* file this brief in support of Petitioner herein.[4]

This brief *amici curiae* in support of Petitioner is submitted with the consent of the parties, as provided in Rule 36.2, Rules of the Supreme Court of the United States.

SUMMARY OF ARGUMENT

I.

A. In interpreting federal statutes, including tax statutes, courts have a duty to look first to the literal language of the statutes and assume that Congress meant exactly what it said. If a natural reading of the statutes does not give rise to absurd results, courts must apply statutes as written.

B. A natural reading of the three statutes at issue requires the conclusion that when the IRS proposes changes to a Subchapter S corporation's income or loss, the statute of limitations commences upon the filing of the corporation's return. The reasoning is as follows: while a Subchapter S corporation is not (by virtue of Section 1372(b)(1)) subject to income tax, and therefore is not required (by Section 6012(a)(2)) to file an income tax return, under Section 6037

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4 Petitioner should never have had to address the Subchapter S issue on which Second Circuit decided the case. Petitioner executed an extension of the statute of limitations that was limited to adjustments to distributive shares in "any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's tax return)." 952 F.2d at 678. Such a limited extension of the statute of limitations should not encompass the net operating loss reported on Petitioner's return attributable to his ownership of a Subchapter S corporation. *See, e.g., Armco, Inc. v. Commissioner*, 88 T.C. 946 (1987); *Bauer v. Commissioner*, T.C. Memo 1992-257; *Russello v. Commissioner*, T.C. Memo 1989-391.

its net income or net loss is reported on an information return. That information return, by the very language of Section 6037, is a corporate return filed pursuant to Section 6012 for statute of limitations purposes. Consequently, when the IRS proposes changes to a Subchapter S corporation's net income or net loss, it must raise the issue within the three-year statute of limitations that commences when the corporate return is filed. Legally, if the IRS permits the three years to pass after a Subchapter S corporation's return is filed without proposing changes, that failure is a determination that no additional taxes are due with respect to the Subchapter S corporation's return.

C. The court below held that Section 6501(a)'s three-year statute of limitations on assessment could only refer to the "return" of the person, *i.e.*, the shareholder, whose liability is being assessed. However, Section 6501(a) does not specify whose return is at issue, nor does it address against whom assessment is to be directed. The last sentence of Section 6037 supplies the answer to whose return is at issue--the return of the Subchapter S corporation--and the substantive provisions of Subchapter S direct that the liability associated with that return is that of the shareholder. For these reasons, for the IRS to timely propose changes to a return of a Subchapter S corporation, the three-year statute of limitations with respect to that return must be open; to assess the tax attributable thereto, the three-year statute of limitations with respect to the shareholder must also be open.

II.

A. Legislative history properly may be consulted only when a patent ambiguity exists in the statute. Even though there is no ambiguity in the three statutes at issue, two courts of appeals resorted to language in the legislative history of Section 6037, in which an "example" is given.

Those two courts of appeals concluded that the "example" set out in the legislative history was not an "example" at all, implying that the Senate Finance Committee misspoke. Those courts concluded that the "example" expresses the only instance in which the statute of limitations commences with the filing of a Subchapter S corporation's return. Such conclusion if legally erroneous.

B. After ignoring the "for example" language in the Senate Finance Committee's report, the Second, Fifth and Eleventh circuits, to reach a conclusion in favor of the government, then read Section 6037 by eliminating the word **"any"** in the following context: the last sentence of Section 6037 states: **"Any** [Subchapter S corporation] return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012." (Emphasis added.) Those circuits held, in effect, that only one type of Subchapter S return, one in which the Subchapter S election is defective, is treated as a corporate return for statute of limitations purposes. In normal English, "any" encompasses each and every return filed by a Subchapter S corporation, whether taxable or not or whether it had made a defective Subchapter S election or not. In effect, then, these three courts "interpreted" Section 6037 as though Congress had not inserted the word "any" in the statute.

C. The attempt to limit the construction of the last sentence of Section 6037 to the "example" cited in the legislative history of that section, coupled with the reading of "any" out of Section 6037 itself are the legal errors that lead to the erroneous conclusions in the court below. The Ninth Circuit's *Kelley* opinion correctly analyzed the three statutes at issue and harmonized the legislative history with those statutes.

ARGUMENT

I. THE PLAIN LANGUAGE OF THE CONTROLLING STATUTES IN THE INTERNAL REVENUE CODE DIRECTS THAT THE STATUTORY PERIOD FOR ASSESSING ADDITIONAL INCOME TAX AGAINST SHAREHOLDERS OF A SUBCHAPTER S CORPORATION FOR ADJUSTMENT TO THE SUBCHAPTER S CORPORATION'S RETURN COMMENCES WITH THE FILING OF THE CORPORATE RETURN.

A. In Interpreting the Meaning of Statutory Phrases, the Words of the Statutes Are to Be Accorded Their "Plain Meaning" Unless a "Natural Reading" of Those Words Leads to an Absurd Result.

This Court granted certiorari, __ U.S.__,112 S. Ct. 2990 (1992), to resolve the conflict among the courts of appeals as to whether the "return" which starts the statute of limitations on assessment of tax deficiencies attributable to the "flow-through" of Subchapter S corporation income or loss is the "return" of the corporation or the "return" of the individual shareholder. It is the view of *amici curiae* that the plain language of the Internal Revenue Code leads to the conclusion that the statute of limitations commences with the filing of the corporate return.

In the interpretation of a federal statute, the duty of courts is to construe the language of the statute so as to give effect to the intent of Congress as expressed in that statute. In fulfilling this duty, courts must look first to the literal

meaning of the words employed in the statute, *Flora v. United States*, 357 U.S. 63, 65 (1958), using a "natural reading," *Patterson v. Shumate*, ___ U.S. ___, 112 S. Ct. 2242, 2246 (1992), and assuming "that Congress said what it meant and meant what it said." *Pettis ex rel. United States v. Morrison-Knudsen Co.*, 577 F.2d 668, 672 (9th Cir. 1978). When statutory language is not ambiguous and does not lead to absurd results, courts must apply the statutes as written. *Arline v. School Bd.*, 772 F.2d 759, 762 (11th Cir. 1985), *aff'd*, 480 U.S. 273 (1987). The job, then, is to determine the "natural reading" and plain meaning of the three statutes at issue. *Amici curiae* will demonstrate that their plain meaning is that the statute of limitations with respect to the Subchapter S corporation's return governs any adjustments to income or loss originating on that return.

B. The Interrelationship Among the Three Statutes at Issue Constitutes a Clear Directive that the Subchapter S Corporation's Return Is the Controlling Return when the IRS Decides to Adjust Income or Loss on that Return.

For the 1979 taxable year at issue in Petitioner's case, if a corporation made an election to be taxed as a Subchapter S corporation, its income or loss would be reported on its own tax return, but the tax liability (or tax benefits) associated with the Subchapter S corporation's return would be a liability of (or a benefit to) the corporation's shareholders, pro rata to their share ownership. Section 6037[5]; Section 1372(b)(1); Section 1373(b); Section 1374(b). As a consequence, the effect of Subchapter S corporation

5 All citations to "Section" are to the Internal Revenue Code of 1954, as amended and effective for the 1979 year, codified at 26 U.S.C., unless specifically stated to the contrary.

status is that "such corporation shall not be subject to the taxes imposed by this chapter * * *." Section 1372(b)(1). The "chapter" reference in Section 1372(b)(1) is to Chapter 1 of the Internal Revenue Code of 1954, as amended, entitled "Normal Taxes and Surtaxes." Chapter 1 is a part of Subtitle A, which is entitled "Income Taxes."

Since the Subchapter S corporation is not subject to income taxes, the next issue is whether such corporation must file a tax return. The statute specifying which taxpayers must file income tax returns is Section 6012.[6] In pertinent part, Section 6012(a) commands that "[r]eturns with respect to income taxes under subtitle A shall be made" by certain persons enumerated by the subsections of the statute. Thus, Section 6012(a)(1) requires individuals having gross income in excess of the exemption amount to file returns, and Section 6012(a)(2) requires "[e]very corporation subject to taxation under subtitle A" to file returns.

Since, by virtue of Section 1372(b)(1), a Subchapter S corporation is not subject to income taxes, at first blush it appears that under Section 6012(a)(2) it cannot be a "corporation subject to taxation under subtitle A," and thus has no duty to file an income tax return. However, this conclusion ignores another mandate, Section 6037, which for the year at issue, stated:[7]

6 Section 6012 is placed in Subtitle F, "Procedure and Administration," Chapter 61, "Information and Returns," Subchapter A, "Returns and Records," Part B, "Income Tax Returns," Subpart II, "Tax Returns or Statements."

7 Section 6037 is placed in Subtitle F, "Procedure and Administration," Chapter 61, "Information and Returns," Subchapter A, "Returns and Records," Part III, "Information Returns," Subpart A, "Information Concerning Persons Subject to Special Provisions."

> Every electing small business corporation (as defined in section 1371(b)) shall make a return for each taxable year * * *. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.

Congress placed Section 6037 in the part of the Internal Revenue Code addressing information returns. Because (under Section 1372(b)(1)) Subchapter S corporations are not subject to taxation, and only corporations subject to taxation are required to file returns "with respect to income taxes" (Section 6012(a)(2)), it is clear that the return contemplated by Section 6037 is an information return, not a tax return for a taxable corporation.[8]

That conclusion that a Subchapter S corporation return is an information return (not a tax return) is, of course, completely consistent with the genesis of Subchapter S. At the time that Subchapter S was added to the Internal Revenue Code, it was impossible for a Subchapter S corporation as such to be taxable: it was a fully "flow-through" entity, whose net income or net loss was treated as

8 Petitioner takes the position that the return filed by the Subchapter S corporation is an income tax return, not an information return. It is true, as Petitioner argues, that there are substantial differences in form between the return filed by a Subchapter S corporation and the return filed by a partnership. Whatever the nature of the return filed by a Subchapter S corporation, one thing is clear: by virtue of the last sentence of Section 6037, any Subchapter S corporation's return is "treated" as a return filed under Section 6012 for the sole purpose of applying the statute of limitations and thus it is, for that purpose, deemed to be a return "with respect to income taxes under subtitle A." Section 6012(a).

the income or loss of the shareholder.[9] Technical Amendment Act of 1958, Pub. L. No. 85-866, § 64(a), 1985 U.S.C.C.A.N. (72 Stat. 1606) 1925, 1980.

Even though a Subchapter S corporation's return is an information return, in Section 6037, Congress mandated, for statute of limitations purposes, that such information return be treated as an income tax return: "Any return filed pursuant to this section shall, for purposes of chapter 66[10] (relating to limitations), be treated as a return filed by the corporation under section 6012."[11] The reference to

2 Subchapter S corporations did not themselves become subject to taxation until eight years after enactment of Subchapter S. On March 2, 1966, a Subchapter S corporation became subject to one corporate-level tax, the tax on net capital gains of Section 1378. S. Rep. No. 1007, 89th Cong. 2d Sess. 1 (1966), *reprinted in* 1966 U.S.C.C.A.N. 2141, 2146. This was the only corporate-level tax applicable to Subchapter S corporations during the 1979 year at issue herein.

Subsequently, Congress has chosen to add additional corporate-level taxes to Subchapter S. These include the tax on built-in gains, the tax on excessive passive investment income, and the recapture of deferred income generated by use of the last-in, first-out method of inventory identification. 26 U.S.C Sections 1374, 1375 and 1363(d), Internal Revenue Code of 1986, as amended.

10 Chapter 66 appears in Subtitle F, "Procedure and Administration," Chapter 66, "Limitations," Subchapter S, "Limitations on Assessment and Collection."

11 As stated in footnote 9, when enacted, there were no corporate-level income taxes applicable to Subchapter S corporations. Nor were any corporate-level penalty taxes applicable to Subchapter S corporations. For example, Section 6651, entitled "Failure to File Tax Return," as it existed in 1958, did not impose a penalty upon the non or late filing of a Subchapter S return. The statute provided:

> In case of failure to file any return required

"limitations" in Section 6037 is to Section 6501(a), the governing statute of limitations on assessment of income taxes, which specifies that income taxes must be assessed "within 3 years after the return was filed * * *." However, with respect to IRS audit adjustments relating solely to Subchapter S items, Section 6501(a) does not address *which* return--the corporation's or the shareholder's--commences the three-year period. Section 6037 answers that question when it provides that the Subchapter S corporation's information return shall "be treated as a return filed by the corporation under section 6012," *i.e.*, as the income tax return of a corporation that is subject to tax which is required to file an income tax return pursuant to Section 6012(a)(2).

The unmistakable result of the interplay of these three statutes--Section 6012(a)(2), Section 6037 and Section 6501(a)--is to foreclose IRS audit adjustments to income or loss originating on a Subchapter S corporation's return after three years from the date of filing that return, even if the return for the individual shareholder remains subject to audit. This is because once the statute of limitations has run on the Subchapter S corporation's return, that expiration, itself, is a determination that no additional tax is due **with respect to** the Subchapter S corporate return. *E.g.*, *Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989); *Diamond Gardner Corp. v. Commissioner*, 38 T.C. 875 (1962); *Estate*

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under authority of subchapter A of chapter 61 (other than part III hereof), [a penalty shall be imposed].

The referenced Part III governed information returns and included Section 6037, the provision requiring a Subchapter S return to be filed. Since Section 6651 appeared in Chapter 68, "Additions to the Tax, Additional Amounts, and Assessable Penalties," rather than Chapter 66 (relating to limitations), the corporate income tax return treatment given to Subchapter S corporation returns by the last sentence of Section 6037 would not apply.

of King v. Commissioner, T.C. Memo 1991-151.

C. The Commissioner's Reading of the Controlling Statutes Creates Ambiguity Where None Exists.

Given the clarity of the relevant statutes, the Commissioner "bears an 'exceptionally heavy' burden of persuading [the Court] that Congress intended to limit" the word "return" in Section 6501(a) to the return of the individual shareholder, rather than the return of the Subchapter S corporation. *Patterson v. Shumate*, _____ U.S. _____, 112 S. Ct. 2242, 2248 (1992). In attempting to meet this burden, the government argued below, and the Second Circuit held, that the "return" to which the statute of limitations applies is the return of the individual whose liability is being assessed, and not that of an entity whose return reports the transaction that gives rise to the liability. *Bufferd v. Commissioner*, 952 F.2d 675, 677, *citing Siben v. Commissioner*, 930 F.2d 1034, 1035 (2d Cir.), *cert. denied*, _____U.S._____, 112 S. Ct. 429 (1991). The Second Circuit stated that "Section 6501(a) does not bar adjustments to an entity's return that do not result in a tax assessment on that entity." *Bufferd*, 952 F.2d at 677.

The Second Circuit has misinterpreted Section 6501(a), which simply states that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed * * *." In the context of a Subchapter S corporation, Section 6501(a) does not address whose *return* is at issue, nor does it address against *whom* assessment is to be directed.

But this lack of guidance in Section 6501(a) is remedied by the substantive provisions of Subchapter S. According to Section 1373(a), "[t]he undistributed taxable income of an electing small business corporation for any taxable year shall be included in the gross income of the shareholders of such corporation in the manner and to the extent set forth in this section." If the Subchapter S corporation were profitable during the year, each shareholder must report his or her pro rata share of the corporation's income as a dividend. Section 1373(b). If the Subchapter S corporation experienced a loss during the year, each shareholder must report his or her share of the corporation's loss as a net operating loss attributable to the trade or business in which the corporation was engaged. Section 1374(b).[12]

Thus, income subject to tax or the loss that may be deducted as a result of the operations of the Subchapter S corporation is computed at the level of the Subchapter S corporation, and the running of the statute of limitations with respect to the corporate return fixes the amount of that income or loss from the Subchapter S corporation; such running itself is a determination that no additional tax is due **with respect to such return**. *E.g.*, *Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989); *Diamond Gardner Corp. v. Commissioner*, 38 T.C.,875 (1962); *Estate of King*

12 Accordingly, taxable income or loss of a Subchapter S corporation was computed in almost the same manner of a taxable corporation. After enactment of the Subchapter S Revision Act of 1982, P.L. 97-354, 96 Stat. 1669, each item making up the income or loss of an S corporation maintained its character as such and was treated as earned or incurred directly by the shareholder. 26 U.S.C. Section 1366(b), Internal Revenue Code of 1986, as amended. After 1982, adopting the partnership scheme, S corporation income and expense items were not netted together to produce one bottom-line dividend (in the event of a net gain) or net operating loss (in the event of a net loss).

v. Commissioner, T.C. Memo 1991-151. On the other hand, since by statute the IRS must look to the shareholder for assessment of the tax liability attributable to the Subchapter S corporation's return, the statute of limitations on assessment applies at the shareholder level.[13]

13 Because the last sentence of Section 6037 treats a Subchapter S corporation's return as a corporate return for statute of limitations purposes, the Commissioner's reliance in the lower courts on *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180 (1957), is misplaced. In that case this Court held that information returns filed by a purportedly non-profit club **did not** constitute returns for purposes of the three-year statute of limitations on deficiency assessment of income taxes. The actual result of *Automobile Club* has since been reversed by statute. 26 U.S.C. Section 6501(g), enacted as part of the Internal Revenue Code of 1954, H.R. 8300, "A Bill to Revise the Internal Revenue Laws of the United States." However, for circumstances not governed by Section 6501(g), the holding continues to be good law. Since the automobile club did not qualify for tax exempt status, it was taxed as a regular corporation, which must file an income tax return pursuant to Section 6012(a)(2).

In that regard, the facts of *Automobile Club* are very much like an invalidly electing Subchapter S corporation, which would also be taxed as a regular corporation. Since Section 6501(g) has no application to Subchapter S returns, the holding of *Automobile Club* would say that the Subchapter S corporation return is not a return for statute of limitation purposes. However, the application of *Automobile Club* to the invalidly-electing Subchapter S corporation is expressly precluded by statute: the last sentence of Section 6037 says that, among other situations, the Subchapter S corporation's information return shall, for limitations purposes, be treated as a return of the corporation.

The holding in *Automobile Club* was mandated by the definition of a return as a filing with sufficient data to compute and assess the tax liability of the enterprise. 353 U.S. at 188. Since the information returns at issue therein did not contain such data, they did not constitute returns. Contrast the requirements in Section 1373(d) and Section 1374(c), which state that taxable income of a Subchapter S corporation is computed to give rise to one number as the income or loss of the

The net result of the treatment (under Section 6037) of the Subchapter S corporation's return as a corporate income tax return is that for the IRS to make audit adjustments to a Subchapter S corporation's return, its statute of limitations must be open; to assess the liability associated therewith from the shareholder, his or her statute of limitations must be open as well. Simply stated, in order to adjust tax liability, the IRS must be able to do so at the Subchapter S level, *i.e.*, the source of the income, or else the IRS will be prevented from doing so at the point where the income is taxed. *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989); *Fendell v. Commissioner*, 906 F.2d 362 (8th Cir. 1990)(expiration of the statute of limitations with respect to a trust barred adjustment to the trust beneficiary's return); *Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989)(no transferee liability may be asserted against an estate beneficiary for estate taxes after the expiration of the statute of limitations for the estate taxes had expired); *Boatmen's First Nat'l Bank v. United States*, 705 F. Supp. 1407 (W.D. Mo. 1988)(the Commissioner cannot revalue gifts for the purpose of calculating estate tax after the expiration of the statute of limitations on the gift tax return).[14]

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corporation, which is then reported by the shareholders pro rata to their stockholdings. Since for limitations purposes, this Subchapter S corporation return is a corporate return pursuant to Section 6037, the fact that a Subchapter S corporation return might or might not contain sufficient data to compute and assess a tax liability at the corporate level is irrelevant. *But cf.*, *Roschuni v. Commissioner*, 44 T.C. 80, 85 (1965)(a Subchapter S corporation's return is merely an adjunct to the return of the individual shareholders and must be considered as part of the shareholders' returns).

14 In 1982, Congress enacted a new method of auditing partnerships and Subchapter S corporations. Because these amendments were codified by the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248 (96 Stat. 324), they often are referred to as the "TEFRA" or "entity-level" audit rules. 26 U.S.C. Sections 6221-6233, Internal Revenue Code of 1986, as amended (partnership audit provisions); 26 U.S.C. Sections 6241-6245, Internal Revenue Code of 1986, as amended (S corporation audit provisions). The effect of this enactment is to remove the dual statute of limitations issue addressed in this brief. Post-1982, the statute of limitations is applied only at the partnership level or the S corporation level, unless the entity is not subject to those rules because it is a "small" partnership or a "small" S corporation. 26 U.S.C. Section 6231(a)(1)(B) and 26 U.S.C. Section 6244, Internal Revenue Code of 1986, as amended.

II. A CAREFUL REVIEW OF LEGISLATIVE HISTORY DEMONSTRATES THAT THE STATUTE OF LIMITATIONS FOR ADJUSTMENTS TO SUBCHAPTER S CORPORATION INCOME OR LOSS COMMENCES WHEN THE SUBCHAPTER S CORPORATION FILES ITS RETURN.

A. The Fifth and Eleventh Circuit Courts of Appeals in *Green* and *Fehlhaber* Have Rewritten the Last Sentence of Section 6037 by Reference to a Single Example in the Legislative History of that Section that by its Wording Does Not Purport to Constitute the Only Application of the Sentence.

Although courts "appropriately may refer to a statute's legislative history to resolve statutory ambiguity," *Toibb v. Radloff*, _____U.S._____, 111 S. Ct. 2197, at 2200 (1991), statutory clarity "obviates the need for any such inquiry." *Patterson v. Shumate*, _____U.S._____, 112 S. Ct. 2242, 2248 (1992). In ruling on the limitations issue

presented herein, two appeals courts have relied upon a statement posited as an "example" in the Senate Finance Committee report as the foundation for their conclusions that Congress intended the Subchapter S corporate's return to be the governing return for statute of limitations purposes only when the corporation itself is subject to tax liability. *Green v. Commissioner*, 963 F.2d 783, 790 (5th Cir. 1992); *Fehlhaber v. Commissioner*, 954 F.2d 653, 656 (11th Cir. 1992). That committee report states (S. Rep. No. 1983, 85th Cong., 2d Sess. (1958), *reprinted in* 1958-3 C.B. 922, 1147)(emphasis added):

> Notwithstanding the fact that an electing small-business corporation is not subject to the tax imposed by chapter 1 of the 1954 Code, such corporation must make a return for each taxable year in accordance with new section 6037 as added by subsection (c) of section 68 of the bill. **Such return will be considered as a return filed under section 6012 for purposes of the provisions of chapter 66, relating to limitations. Thus, for example, the period of limitation on assessment and collection of any corporate tax found to be due upon a subsequent determination that the corporation was not entitled to the benefits of subchapter S, will run from the date of filing of the return required under the new section 6037.**

The Fifth and Eleventh Circuits erred in viewing the words "for example" as setting forth the sole instance in which a Subchapter S corporation's return would commence the statute of limitations with respect to IRS audit adjustment

of Subchapter S income or loss. An "example" has never been an exclusive or exhaustive listing: *exempla illustrant non restringunt legum*. If "for example" means anything at all, it must refer to situations other than that referred to in the committee report's example, *i.e.*, an invalid Subchapter S election in which the Subchapter S corporation's tax return is treated as a corporate tax return. Both the Fifth and the Eleventh circuits erred in resorting to legislative history in the first place (because the three statutes are patently clear), and when doing so ignoring the Senate Finance Committee's "for example" language; that language undermines and precludes the very conclusions those two circuits reached.

The courts of appeals are trying to create law contrary to what Congress said. *Blanchard v. Bergeron*, 489 U.S. 87, 97-99 (1989). As stated by the Ninth Circuit (*Kelley v. Commissioner*, 877 F.2d 756, 759 (9th Cir. 1989)):

> If Congress had intended the example to swallow the language of the text, Congress could easily have written the statute to provide that the period of limitations will run from the date of filing of the return required under section 6037 *only* in instances of a subsequent determination that a corporation was not entitled to the benefits of Subchapter S.

B. The Second, Fifth and Eleventh Circuit Courts of Appeals in *Bufferd, Green* and *Fehlhaber* Have Rendered Surplusage Congress' Use of the Modifier "Any" in the Last Sentence of Section 6037.

The Ninth Circuit (in *Kelley*) has made the only interpretation of Section 6037 that gives effect to the adjective "any" that appears in the last sentence of Section

6037. "**Any** [Subchapter S corporation] return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012." (Emphasis added.) When Subchapter S was added to the Internal Revenue Code in 1958, "**any** return" included only two classes of returns: (i) the return of a validly electing Subchapter S corporation, and (ii) the return of a Subchapter S corporation that is taxable because of a defective Subchapter S election. (After 1966, when Subchapter S corporations were made taxable on certain transactions (footnote 9, *supra*), "any return" also referred to such Subchapter S corporations.) According to Section 6037, "any return" shall constitute a return for purposes of commencing the statute of limitations for adjustments made at the corporate level. No other genuine interpretation of the last sentence of Section 6037 is possible. This common-sense approach underscores the wisdom in the rule of statutory construction that statutes should not be construed to render any provision surplusage and that every word employed by Congress should be given effect. *E.g., United States v. Menasche*, 348 U.S. 528 (1955).

The conclusions reached by the Second, Fifth and Eleventh Circuits are possible only if "any" is read out of the text of Section 6037. For this additional reason, those Circuits' opinions are erroneous.

C. Congress Did Not, in Legislative History, Manifest an Intent to Override the Sweeping Statutory Language of the Last Sentence of Section 6037.

Through the use of the words "for example," the legislative history of Section 6037 sets forth one of several obvious illustrations of the application of the last sentence of

that section. Further, the statutory word "any" (in Section 6037 since 1958) is completely in harmony with "for example." In no event can this legislative history be interpreted as clearly expressed legislative intent that Section 6037's last sentence be limited to the sole situation in which the Subchapter S election was ineffective. "Absent a clearly expressed legislative intent to the contrary, [the statutory] language must ordinarily be regarded as conclusive." *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 862 (1983), *citing Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

The question in this case is whether Section 6037 means what it says, or whether the courts may rewrite Section 6037 so that it applies only in the instance in which the corporation itself owes a tax liability because the Subchapter S election is invalid. By the use of "for example," the Senate Finance Committee itself stated that the invalidity of the Subchapter S election was but one of several instances in which the last sentence of Section 6037 would be applicable.[15] Therefore, if the last sentence of Section 6037 is to be given any effect, it must mean what it literally says: that the statute of limitations on IRS audit adjustments to "any" Subchapter S return is governed by the corporate return filing date.

This result is not "absurd." Indeed, it is consistent with the purpose of statutes of limitations (*Rothensies v.*

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15 It is obvious, as is pointed out in Petitioner's main brief, that the Second, Fifth and Eleventh circuits legally erred in relying on the proposition that "for example" referred to two situations: (1) when the Subchapter S election was invalid, and (2) when the Subchapter S corporation is subject to net capital gains tax. The reason is that net capital gains tax was not imposed on Subchapter S corporations until eight years after the "for example" language was enacted. *See* Note 9, *supra*.

Electric Storage Battery Co., 329 U.S. 296, 301 (1946)):

> [Congress has regarded it as] ill-advised to have an income tax system under which there would never come a day of final settlement and which required both a taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, and recall details of all that goes into an income tax contest. * * * The theory is that even if one has a just claim, it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them.

As the Ninth Circuit aptly stated (*Kelley v. Commissioner*, 877 F.2d at 758):[16]

> The shareholder can defend against such an adjustment [by the IRS to a Subchapter S corporation's return] only by resort to the corporation's books and records. The statute of limitations exists, in part, so that after some time persons can be confident that their affairs are closed and they can dispose of old records. An S corporation should be entitled to the same finality as others, yet [pursuant to the government's argument] if any of the shareholders has given an extension of the statute of limitations to the IRS[,] the shareholder's ability to defend against the adjustment would depend upon whether the corporation has retained the records.

16 In *Brody v. Commissioner* (one of *amici curiae*), the IRS sent its proposed audit adjustment to Mr. Brody eight years after the Subchapter S corporation's year end. Because of the delay, Mr. Brody was unable to obtain the Subchapter S corporation's records.

CONCLUSION

For the reasons stated in *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989), in Petitioner's brief, and herein, the judgment of the United States Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

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No. 91-7804

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Respondent

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BRIEF OF AMICUS CURIAE ON THE MERITS IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Does the express language of §6037 of the Internal Revenue Code permit the Commissioner to adjust the taxable income of an S corporation after the statute of limitations on the corporation's return has run?

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INTEREST OF AMICUS CURIAE

Amici Curiae[1] are members of the Washington State Bar whose practice focuses on federal tax planning and resolution of federal tax controversies. They were counsel for the taxpayer in *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989). Their interest is that this Court fully be advised of the origins and effect of the law governing Subchapter S corporations under the Internal Revenue Code of 1954.

SUMMARY OF ARGUMENT

Section 6501(a) of the Internal Revenue Code provides a three-year period of time from the date of filing a "return" during which the Internal Revenue Service may adjust any items on that filed "return" and assess an income tax imposed by the Code. If, within the period of limitations on that "return" the Service concludes that adjustments should be made to that "return" the Service may assess income tax imposed by the Code on either the person who filed that "return," or another related person whose return is based (in part) on that return and whose period of limitations is also open.

The clear and straightforward meaning of the term "return" in §6501(a) as further described in the second sentence of §6037(a), makes it irrelevant whether an income tax is assessed against the S corporation. Therefore, the Service may not adjust items on the S corporation's income tax return more than three years after that return was filed.

The Subchapter S corporation was created in 1958. At its inception, it was subject to no income tax whatsoever. It was required to file an income tax return and provide an

[1] Pursuant to United States Supreme Court Rule 37.3, *amici* have obtained the written consents of all parties, which accompany this brief.

information statement to shareholders. The information statement contained no breakdown of the character or derivation of the corporation's income or loss. The effect was the same as receiving a dividend statement from a C corporation. The treatment of all items of expense, income, deduction, and credit were determined at the corporate level and a shareholder may not have access to those records.

Section 6037, which was enacted at the same time as the subchapter S corporation, expressly applied the statute of limitations under §6501 to the return filed by the Subchapter S corporation. At the time it was enacted, a Subchapter S corporation was not liable for any income tax. A separate Section 6037 was unnecessary if its only purpose was to describe the application of the statute of limitations to a failed Subchapter S corporation. A small change to the recently enacted §6501(g) would have sufficed.

Section 6037 is clear and unequivocal on its face and resort to legislative history is unnecessary. The biggest problem with the legislative history is that it can and has been contorted by the government and the Second Circuit. The contortion occurs by taking the words "for example" and concluding that they are surplusage; that the "example" is the definition. To the extent that the legislative history is probative, it supports the petitioner's position. The legislative history of the 1982 amendments to the IRS are even less probative as to the meaning and interpretation of §6037 than the history in 1958.

Section 6037 is not analogous to §6501(g) of the Code. Section 6501(g) was in the Code when §6037 was adopted by Congress. If Congress had wanted to provide a provision like §6501(g) for subchapter S corporation it could have done so.

The final argument for the interpretation of §6037 by the *Kelley* court is the potential for inequitable and incongrous results to the shareholders of a Subchapter S corporation.

The sole sources of information on any of the items of income and expense are the corporation's return and the corporation's books. It is the corporation's taxable income or loss. Neither the Internal Revenue Service nor anyone else can determine the taxable income or loss of the corporation without exclusive reference to the corporation's return and records. Congress recognized this in 1958 and provided that the corporation's return was a "return" for purposes of the statute of limitations.

ARGUMENT

I. The Technical Amendments Act of 1958 created a new entity under the Internal Revenue Code, the Subchapter S corporation, and established a Code section governing the status of its return.

The Technical Amendments Act of 1958 created an entirely new subchapter in the Internal Revenue Code and a new type of organization for tax purposes, the Subchapter S corporation. Subchapter S was added to the 1958 Act by the Senate; it was not a part of the original House Bill. S. Rep. 85-1983, 85th Cong. 2d Sess., 1958 U.S. Code, Cong. & Admin. News 5005.

The provisions of the Internal Revenue Code governing the Subchapter S corporations have changed markedly from their inception in 1958.[2]

The "Subchapter S corporation" and the post-1982 "S corporation" are not the same. At its inception, the

[2] The years at issue pre-date the Subchapter S Revision Act of 1982, which changed the shorthand description of "an electing small business corporation" from "Subchapter S corporation" to "S corporation." This brief uses the term as applied to electing small business corporations before the 1982 revisions.

Subchapter S corporation operated like a corporation for tax purposes. Items of income (except long-term capital gain) or loss lost their character when passed through to shareholders. The taxable income of the corporation was included in the shareholders' income as a dividend. IRC §1373(b) (as in effect before the 1982 amendments); S. Rep. 85-1983, 85th Cong. 2d Sess., 1958 U.S. Code, Cong. & Admin. News 5007. The "net operating loss" of the corporation was also passed through to the shareholders. IRC §1374 (as in effect before the 1982 amendments); S. Rep. 85-1983, 85th Cong. 2d Sess., 1958 Code, Cong. & Admin. News 5008. No separate characterization of each item generating income (except long-term capital gains) or loss was made. The Subchapter S corporation was just that - a corporation whose net income or loss was taxed to its shareholders. The Chairman of the Senate Finance Committee summarized Subchapter S, stating

> "[It] . . . permits shareholders in small-business corporations, in lieu of payment of the corporation tax, to elect to be taxed directly on the corporate earnings. When this method is elected, the shareholders include in their own income for tax purposes their share of the current taxable income of the corporation, whether distributed or not. 104 Cong. Rec. 17,034-17,035 (1958).

A new section of the Code was also added, governing the treatment of a Subchapter S corporation return. IRC §6037. The new section was separate from the general rules regarding the status of returns for the statutes of limitation in IRC §6501.

In 1982, the "S corporation" supplanted the "Subchapter S corporation." The treatment of an S corporation's income and loss was changed from a "corporate" model to a

"partnership" model. S. Rep. 97-640, 97th Cong. 2d Sess., 1982 U.S. Code, Cong. & Admin. News 3257-3258, reprinted at 1982-2 C.B. 718. No longer would there be a pass through of the corporation's taxable income or net operating loss. Instead, each item on the corporation's return that might affect the liability of any shareholder would be treated separately.[3]

The treatment of all items of expense, income, deduction and credit of a Subchapter S corporation is determined at the corporation level. A shareholder does not have personal possession of records to substantiate the deductions taken on the return. Further, a shareholder has limited rights to inspect corporate records. For example, under Connecticut law, a shareholder may obtain access only to certain records of a corporation.

2. The Second Circuit's analysis in Bufferd is not supported by the statutory language and legislative history of the 1958 law, creating the Subchapter S corporation and making its return a "return" for purposes of the statute of limitations.

Section 6037 came into the Internal Revenue Code in 1958, along with the Subchapter S corporation. It states, "any return filed pursuant to this section shall, for purposes of Chapter 66 (relating to limitations), be treated as a return filed by the corporation under §6012." The legislative history regarding §6037 states:

[3] There had been earlier proposals of this nature, but they had not been enacted. Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders*, §6.05, n. 56 (4th ed. 1979).

> Notwithstanding the fact that an electing small-business corporation is not subject to the tax imposed by Chapter 1 of the 1954 Code, such corporation must make a return for each taxable year in accordance with new §6037 as added by subsection (c) of §68 of the Bill. Such return will be considered as a return filed under §6012 for purposes of the provisions of Chapter 66, relating to limitations. Thus, for example, the period of limitation on assessment and collection of any corporate tax found to be due upon a subsequent determination that the corporation was not entitled to the benefits of Subchapter S, will run from the date of filing of the return required under the new §6037.

S. Rep. 85-1983, 85th Cong. 2d. Sess, 1958 U.S. Code Cong. & Admin. News 5014.

The Second Circuit concluded that the statutory language applies only where the Subchapter S corporation is "nonetheless required to pay some tax on the organization's income." *Bufferd v. Commissioner*, 952 F.2d 675, 677 (2nd Cir. 1992). The Court relies on the above-quoted legislative history as support for its conclusion that the statutory language applies only to limit the assessment of tax owed by the Subchapter S corporation.

The Second Circuit's analysis is flawed on two counts. First, its opinion ignores the statute governing Subchapter S corporations as enacted in 1958. As enacted, Subchapter S of the Internal Revenue Code of 1954 exempted an "electing small business corporation" from all income taxes. Section 1371(b)(1).

The express language states that, despite not being liable for any income tax, a Subchapter S corporation's return is a return for purposes of "Chapter 66 relating to limitations." §6037. When Subchapter S of the Internal Revenue Code

was enacted, no corporate tax would be shown on a Subchapter S corporation's return, but taxable income, and all necessary information to compute it would. The question becomes, to what "return" does §6501(a) refer?

If this Court determines that "return" clearly means the corporate return that contains the necessary supporting information to compute income and loss it need go no further. The plain meaning of the statute controls unless, in the rare case, the result is "demonstrably at odds with the intention of its drafters." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989). It is not enough that a statute differs from "widely held expectations." *In re Roberts*, 906 F.2d 1440, 1443 (10th Cir. 1990). Only if the issue is not clear from the statutory language itself, is recourse to the legislative history appropriate. *In re Burns*, 887 F.2d 1541, 1544 (11th Cir. 1989).

The evidence needed to show that the plain words are not the intent of Congress must be compelling. "Invocation of the 'plain purpose' of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and in the end prevents effectuation of congressional intent." *Board of Governors v. Dimension Fin. Corp.*, 474 U.S. 361 (1986).

The legislative history of the Technical Amendments Act of 1958, which created Subchapter S of the Internal Revenue Code, is permeated with references to a Subchapter S corporation's exemption from income taxes. "Subchapter S is applicable to a 'small business corporation' which elects not to be subject to the income tax imposed by Chapter 1 of the 1954 Code . . . " S. Rep. 85-1983, 85th Cong. 2d. Sess., 1958 U.S. Code, Cong. & Admin. News 5005. The legislative history continues, "under §1372(b)(1), the effect on a small-business corporation of a valid election is to exempt the corporation from income tax for any taxable year with respect to which the election is in effect . . . " S.

Rep. 85-1983, 85th Cong., 2d Sess., 1958 U.S. Code, Cong. and Admin. News, 5005. "Notwithstanding the fact that an electing small-business corporation is not subject to [income tax]" its return is a return for purposes of the statute of limitations. *Id.* at 5014.

When §6037 was adopted, there was no income tax to be paid by a Subchapter S corporation under any provision of the Internal Revenue Code. Yet, Congress took the specific step of making the return of a Subchapter S corporation a return for purposes of the statute of limitations.

The Second Circuit hypothesizes that §6037 serves the same purpose as §6501(g). In reviewing the history of §6037 and §6501(g), this hypothesis is not supported. Section 6501(g) was part of the Internal Revenue Code, as adopted in 1954, and it had no counterpart in the Internal Revenue Code of 1939. *See Automobile Club of Michigan v. Commissioner*, 353 U.S. 180 (1957), *reh. denied*, 353 U.S. 989. As originally enacted, §6501(g) applied to entities which erroneously characterized themselves as partnerships, or exempt organizations, but which were actually corporations. Section 6501(g) provided limited relief by treating returns that otherwise would not trigger the running of the statute of limitations as returns for "purposes of this section."

Congress did not place the provision governing the status of a Subchapter S corporation return in the narrowly drawn Code §6501(g). Instead, it enacted a new section of the Internal Revenue Code. Furthermore, Congress chose much more expansive language for Code §6037, making a Subchapter S corporation's return a "return," "for purposes of Chapter 66 (relating to limitations)." Chapter 66 includes §6501. The choice of language and the decision by Congress to make the status of a Subchapter S corporation return the subject of a special section of the Code indicates

that the limited scope of §6501(g) was not what Congress intended when enacting §6037.

Differences in the language chosen by Congress should not be dismissed, as the Second Circuit appears to have done with the differences between §6501(g) and §6037.

> Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion. *Russello v. United States*, 464 U.S. 16, 23 (1983), citing *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972).

Neither are differences in Congress' choice of words to be dismissed by ascribing the same meaning to different language or treating the difference as "a simple mistake in draftsmanship." *Id.* The Second Circuit, in *Siben v. Commissioner*, recognized that the differences in the language between the Internal Revenue Code provisions governing partnerships and Subchapter S corporations rendered §6037 inapplicable to an entity other than Subchapter S corporation. 930 F.2d 1034, 1037 (2nd Cir. 1991).

The second flaw in the Second Circuit's analysis is its reading of the legislative history. The Court treated the example given in the Senate Report as a limitation on the statutory language. This violates the ancient maxim, *exempla illustrant non restringunt legem* (examples illustrate, but do not restrain, the law). Black's Law Dictionary, 571 (6th ed. 1990).

As this Court has noted, the ordinary meaning of "example" (involving an example in the regulations under §513 of the Internal Revenue Code) is "an illustration of one possible application" of a provision of the law. *United States v. American College of Physicians*, 475 U.S. 834 (1986).

This Court rejected an argument that an example in the Treasury regulations discussing unrelated business income of an exempt organization established a blanket rule. Likewise, in this case, the term, "for example" in the 1958 legislative history is an illustration of one possible result of Congress carving out a special rule for returns of Subchapter S corporations. The Treasury Regulations, adopted in 1959, repeat the language of the conference report, using the ineligible Subchapter S corporation as one "example." Treas. Reg. §1.6037-1(c). It appears that the Treasury did not interpret the example as a limitation on the scope of §6037 until litigation ensued.

The Second Circuit's interpretation of the legislative history as restricting the statute of limitations to assessment of income tax against the corporation repeats its error regarding the statute itself. A Subchapter S corporation was not liable for any tax on its income under Subchapter S of the Internal Revenue Code as originally enacted. Interpreting the example in the Conference Committee report as the only circumstance in which there is a separate application of the statute of limitations to the corporation's return does violence to the broad statutory language and Congress' choice of the situation as an example.

3. The interpretation of §6037 of the Internal Revenue Code by the Second Circuit would lead to incongruous and inequitable results.

Current Connecticut law acutely demonstrates the unfavorable position the *Bufferd* decision puts shareholders in with respect to locating, examining, and obtaining corporate records. Although shareholders of record are entitled to "reasonable" inspection of certain specified corporate information, such information is hard to get, limited, and falls

far short of giving shareholders the access necessary to meet the demands of potential Internal Revenue challenges.

According to Connecticut's statutory provisions, shareholders of record are entitled to inspect general corporate records such as balance sheets and profit and loss statements (as provided for in Conn. Gen. Stat. Ann. §33-307 (West 1989)) during business hours. Conn. Gen. Stat. Ann. §33-334(a).[4] To examine and make copies and extracts of the corporation's bylaws and its minutes of the meetings of shareholders, the shareholder is required to provide a written request to the corporation detailing a "reasonable and proper purpose" for the examination. Conn. Gen. Stat. Ann. §33-334(b). In each of these instances, shareholder recourse against corporate inaction is found in the courts.

These records, however, fall far short of that necessary to substantiate the bottom line income or loss from a Subchapter S corporation passed through to a shareholder's tax return and sustain it against an IRS challenge. Connecticut law provides procedures through which a shareholder can seek access to operational records of the corporation, but the process is far more difficult than suggested by the *Bufferd* court.

Conn. Gen. Stat. Ann. §33-334(c) provides that only through a court order can a shareholder examine and copy critical corporate books and records of account, and then only after "application by a shareholder of record, after notice to the corporation that it may show cause why such order should not be granted, and after hearing thereon . . ." Furthermore, access to this information is ". . . subject to limitations as said court or such judge may prescribe . . . ," meaning that some records could potentially be kept from the shareholder's reach. Finally, §33-334(c) puts upon the shareholder the burden of showing " . . . that the

[4] The substantive provisions of the statute are unchanged from the year at issue.

examination is in good faith in the interest of such shareholder as such or of the corporation . . ."

Ultimately, the Connecticut corporate law structure demonstrates the difficulties associated with shareholder access to basic, and in many cases critical, information concerning both corporate and individual finance and accounting. Aside from obtaining the basic general corporate records which are too limited to substantiate specific tax claims, the shareholder is required to make written request, prove good cause and "proper purpose," and ultimately obtain a judicial decree just to reach the step of gaining access to corporate records to substantiate the corporation's taxable income or loss.

The *Bufferd* court specifically downplayed this risk, asserting that a shareholder could take "protective steps with regard to the S corporation records needed to support the S corporation items claimed on the shareholder's return."[5] 952 F.2d at 678. As explained above, this overstates the access that a shareholder has to the internal records of a corporation. The risks of limited access are real and can expose a shareholder to adverse tax consequences, even where a shareholder attempts to obtain necessary information, but is unable to do so. *See e.g.*, Rev. Rul. 62-202, 1962-2 C.B. 344 (Minority shareholder of Subchapter S corporation who was not an officer or employee held liable for penalty for underpayment of estimated tax despite his futile efforts to obtain information from corporation needed to determine tax deposits.)

[5] The quoted language indicates that the court below may have incorrectly relied on the law after the 1982 amendments. Before the 1982 amendments, a Subchapter S corporation would not pass through specific items of income, expense, deduction or credit to a shareholder. Instead, only the corporation's total taxable income (with minor adjustments) or net operating loss were passed through. A shareholder in Compo for the 1979 tax year, for example, would not know which item on the corporation's return might be of interest to the Commissioner.

The Second Circuit's interpretation of §6037 opens the door to even more serious inequities.

> **Example 1:** A is a shareholder and owns 20% of X Co., a Subchapter S corporation. B and C, unrelated to A, own 80% of X. A is audited for 1982 and signs a Form 872-A extension of the statute of limitations. The audit focuses on issues other than A's investment in X Co. Ten years go by.[6] The Internal Revenue Service finally issues a statutory notice of deficiency, including a disallowance of a $10,000 loss from X Co. for the tax year 1982. The S corporation loss had not been raised as an issue previously. The records of X Co. have been destroyed.

The shareholder in the example has no means to compel the corporation to retain its records. As discussed above, the shareholder's ability to obtain access to the records is quite limited. The shareholder, in the above example, is completely unable to defend against the Commissioner's adjustments.

The example is not mere philosophical musing. In *Bufferd*, the extension agreement refers only to adjustments arising from a partnership return, but the Commissioner took the position below that the extension agreement also covered his proposed adjustments to the Subchapter S corporation return. 952 F.2d at 676.

The Internal Revenue Service has the ability to, and does, obtain extensions of the statute on the Subchapter S

[6] Form 872-A is an extension of the statute of limitations without any fixed termination date. The Second Circuit has held that there is no "reasonable time" limitation on the Form 872-A extension. *Stenclik v. Commissioner*, 907 F.2d 25 *cert. denied* ___ U.S. ___, 111 S.Ct. 516 (1990).

corporation return.[7] *See Kelley v. Commissioner*, 877 F.2d at 757; *Bufferd v. Commissioner*, T.C. Memo 1991-170, 61 TCM [CCH] 2410, 2411; *Jacobson v. Commissioner*, T.C. Memo 1987-559, 54 TCM [CCH] 1043. It is at the corporate level that all necessary information concerning the corporate return will be found. A shareholder for years before 1983 will have no information relevant to the corporation return, other than a raw number indicating gain or loss. *Ketchum v. Commissioner*, 697 F.2d 466, 469 (2d Cir. 1982). The shareholder therefore would have no information to show how the bottom line income or loss was determined. Basic principles of fairness weigh in favor of applying the statute at the corporate level.

> The shareholder can defend against such an adjustment (to a Subchapter S corporation's return) only by resort to the corporation's books and records. The statute of limitations exists, in part, so that after some time persons can be confident that their affairs are closed and they can dispose of old records. An S corporation should be entitled to the same finality as others, yet if any of the shareholders has given an extension of the statute of limitations to the IRS the shareholder's ability to defend against the adjustment would depend upon whether the corporation has retained the records.

Kelley v. Commissioner, 877 F.2d at 756. The adjustment to the shareholder's return may, in fact, be triggered by the Commissioner's earlier audit of the corporation. *See e.g., Ketchum v. Commissioner*, 697 F.2d at 467.

The interpretation given §6037 by the Second Circuit would create multiple statutes of limitations applicable to a

[7] It appears that the Service not only solicits extensions from the subchapter S corporation, but does so as a policy.

single Subchapter S corporation return, depending on the nature of the adjustment proposed.

> **Example 2:** Assume that an accrual method Subchapter S corporation had a taxable year ending February 28, which is a different taxable year than its shareholders. This was a standard tax planning strategy for the years at issue and a not uncommon situation now. All of the stock of the Subchapter S corporation was owned by husband and wife, both of whom are cash method, calendar year taxpayers, and that the corporation leased property from the shareholders. On March 31, 1977, the husband died, leaving his half of the stock to a trust created under his Will.
>
> The Internal Revenue Service audits the corporate return. It determines that the Subchapter S election terminated because the trust was an ineligible shareholder, which voids the Subchapter S election as of March 1, 1977 (termination at that time was retroactive to the first day of the year of termination). The Internal Revenue Service also determines that the corporation's accrued but unpaid rental expenses were not deductible because the cash-method shareholders had not yet included them in income, under IRC §267.
>
> The shareholders and the corporation disagree with these determinations, contending that the Subchapter S election has not terminated because the executor of husband's estate has not yet distributed the estate assets to the beneficiaries, including the trust (an estate is an eligible shareholder in a Subchapter S corporation). Applying the results reached by the

Second Circuit in this case and assuming that all returns were timely filed, the statute of limitations with respect to the Subchapter S corporation for its year ending February 28, 1978 would expire May 15, 1981, and the statute of limitations with respect to adjustment regarding the rental expense would expire April 15, 1982, provided that the Internal Revenue Service was correct regarding termination of the Subchapter S election. If the shareholders were correct in their assertion that the estate, rather than the trust, held the Subchapter S stock, then the statute of limitations for both issues would expire April 15, 1982.

The statute of limitations anomalies created by the Second Circuit's interpretation are not cured by the application of the consolidated audit procedures to S corporations. *See Arenjay v. Commissioner*, 920 F 2d 269 (5th Cir. 1991). The consolidated audit procedures do not apply to many S corporations. Under current law, related adjustments, from the same return may still be subject to different statutes of limitations.

Example 3: Z is a calendar year S corporation. Until 1988, it had been a regular corporation, and has substantial "earnings and profits." Z owns a large shopping center. It also operates a retail widget store. In 1990, the widget market is terrible. In 1990 Z undertakes repairs to part of the shopping center. It deducts the repairs and passes a $50,000 deduction to its shareholders attributable to the expense of the repairs. Net rents from the other shopping center tenants account for 20% of Z's gross receipts.

Because Z has a Subchapter C "earnings and profits," it could be liable for tax if its net rental (and other passive) income exceeds 25% of its gross receipts. IRC §1375. Z determines that it is not liable for the tax because its net passive income is only 20% of the gross receipts. Z timely files its 1990 return on March 15, 1991.

D, a shareholder, also timely files his 1990 return on April 15, 1991. The Commissioner believes Z should have capitalized the repair costs. Removing the $50,000 deduction will put Z's net passive income over the 25% threshold, triggering liability for tax under §1375.

Under the Second Circuit's analysis, the statute of limitations for denying the repair expense, on which the §1375 tax liability is based expires April 15, 1994, but the statute of limitations for the tax itself expires a month earlier.

4. It is not appropriate to rely on the legislative history of the 1982 amendments to the Internal Revenue Code to ascertain the intent of Congress in 1958.

In 1982, Congress substantially modified the Internal Revenue Code. The Tax Equity and Fiscal Responsibility Act (TEFRA), P.L. 97-248, established a consolidated audit procedure for most partnerships. IRC §6221 et. seq. The audit rules under TEFRA did not extend to Subchapter S corporations. Later in 1982, Congress enacted the Subchapter S Revision Act of 1982. P.L. 97-354. The Act added §§6241-6245 to the Code. P.L. 97-354, §4(a). The

amendments made the audit procedures for partnerships, enacted under TEFRA, applicable to Subchapter S corporations. IRC §6244. The legislative history includes a statement of "present law" that:

> [A]ny issues involving the income or deductions of a Subchapter S corporation are determined separately in administrative or judicial proceedings involving the individual shareholder whose tax liability is affected. The statute of limitations applies at the individual level, based on the returns filed by the individual. The filing by the corporation of its return does not affect the statute of limitations applicable to the shareholders.

S. Rep. 97-640, 97th Cong. 2d. Sess., 1982 U.S. Code Cong. & Admin. News 3275 reprinted at 1982-2 C.B. 718. The *Bufferd* Court relied on a discussion of this legislative history of §6037 by the Tax Court in *Felhaber v. Commissioner*, 94 T.C. 863 (1990) *aff'd* 954 F.2d 653 (11th Cir. 1992).

The Tax Court, in turn, relied on the quoted 1982 legislative history as demonstrating the intent of the original drafters of the bill. *Felhaber v. Commissioner*, 94 T.C. at 867. The interpretation of the later legislative history is not a substitute for the intent of the Congress that enacted §6037. As this Court has long held, ". . .it is well settled that the 'views of a subsequent Congress form a hazardous basis for interring the intent of an earlier one." *Russello v. United States*, 464 U.S. at 26, *quoting Jefferson County Pharmaceutical Assn. v. Abbott Laboratories*, 460 U.S. 150, 165, n.27 (1983), *quoting from United States v. Price*, 361 U.S. 304, 313 (1960).

The risk is particularly great where the later legislative history does not identify the source for its conclusion

regarding the "present law." Here, the later statement relied upon may also be interpreted to be a recitation of the status of the scant caselaw that had developed under §6037. [8] Even if the basis for the statement in the legislative history of the 1982 amendments were clear, this Court has stated its reluctance to permit a later Congress to state the intent of an earlier one. That reluctance should be no less where the later legislative history is inconclusive. *United States v. American College of Physicians*, 475 U.S. at 846-847 (1986).

The Court in *American College of Physicians* was faced with a situation similar to these facts. A later Congress, in its statement of the "Present Law" adopted a particular reading of a statute. The Court declined to adopt an argument by the United States that the later legislative history established what the law had been before. This Court noted that several readings of the later legislative history were possible, including "the Committee's intention affirmatively to endorse what they believed to be existing practice . . ." 475 U.S. at 846. The 1982 legislative history may only be endorsing the view of the statute put forth in the *Leonhart* decision.

Instead of relying on an interpretation by a Congress, a quarter century later, the Court should look to the 1958 act, recognizing the substantial departure that Subchapter S represented by creating a non-taxable entity separate from its

[8] The only case before *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989) to address the meaning of §6037 was an unreported decision of the Tax Court. *Leonhart v. Commissioner*, T.C. Memo 1968-98 *aff'd per curiam on other issues*, 414 F.2d 749 (4th Cir. 1969). The precedential value of Leonhart is very limited. The statute of limitations issues was apparently not raised before the Court of Appeals. The Tax Co[redacted] does not consider it memorandum decisi[redacted] and has [redacted] policy against citing [redacted]. *See e.g. Gale v. Commissioner*, 17 T.C. 1458, 1459 (1952) *rev'd* 210 F.2d [redacted] Cir. 1954). *See also* 2A Casey, Federal Tax Practice, §8.38 (1981).

owners, the broad scope of the language of §6037, Congress' decision to keep §6037 separate from IRC §6501(g) and the broad language of the legislative history.

CONCLUSION

For the forgoing reasons the judgment of the court of Appeals should be reversed.

Respectfully submitted,

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